



DRAFT Accounting Manual for Federal Credit Unions

**For Credit Unions with less
than \$10 Million in Assets**

November 2001

FOREWARD

Credit unions with under \$10 million in assets are provided this *Accounting Manual for Federal Credit Unions* (the Manual) as a guide in accounting for financial transactions and reporting in accordance with regulatory accounting practices (RAP) prescribed herein. The Manual sets forth procedures for the maintenance of accounting records and contains accounting guidelines and requirements for accounting topics of interest such as investments in credit union service organizations, interest method of amortization, securities, repossessed property, share drafts, credit cards, etc. The manual may be adopted by federally insured, state chartered credit unions (FISCUs) under \$10 million in assets at the option of the credit unions and their state supervisor.

In accordance with the *Credit Union Membership Access Act* (CUMAA), credit unions with \$10 million or more in assets must follow generally accepted accounting principles (GAAP) in the call reports they file with the NCUA. These credit union should not look to this Manual but should seek the advice of an independent accountant to gain a full understanding of GAAP and its implementation.

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The NCUA Board gratefully acknowledges the contributions of Office of Examination and Insurance (E&I) Director David M. Marquis, Deputy Director Herbert S. Yolles, Division of Supervision Director Marcia A. Sarrazin and E&I Program Analyst Karen Kelbly .

The NCUA Board and the Office of Examination and Insurance, Division of Supervision gratefully acknowledges the contributions of the following NCUA regional staff in updating and revising the *Accounting Manual for Federal Credit Unions* (names listed alphabetically):

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SUMMARY OF ACCOUNTING MANUAL CHANGES

1. The Manual was rewritten (streamlined and simplified) and targeted to credit unions under \$10 million in assets. The Manual approach is basic and includes several regulatory accounting practices (RAP). As a credit union grows and expands member services, the increased accounting complexities may require the credit union to seek the advice of an independent accountant and move to a GAAP (generally accepted accounting principles) approach.
2. Credit unions with \$10 million or more in assets are now required by the Credit Union Membership Access Act (CUMAA) to report on their call reports consistent with generally accepted accounting principles (GAAP). GAAP are promulgated by the Financial Accounting Standards Board (FASB) and related parties, and the Accounting Standards Executive Committee (AcSEC) of the American Institute of Certified Public Accountants (AICPA) and related parties. Credit union accounting is “regulated” so to speak by these groups. Generally, **the National Credit Union Administration will no longer provide specific “implementation” guidance of FASB and AICPA rules for credit unions with \$10 million or more in assets. These credit unions should not look to this Manual but may need to seek the advice of an independent accountant** to understand and implement the more complex GAAP rules in application to their specific circumstance.
3. The familiar credit union chart of accounts was eliminated. Since credit unions need to report on their call reports consistent with GAAP, credit unions should develop and use a chart of accounts that best facilitates call reporting.
4. The Manual is organized in a way that tracks financial statement reporting: i.e., Assets, Liabilities, Equity, Income, and Expenses. Tables of Contents within each section and tabbing should facilitate the retrieval of reference information.
5. A specialized accounting chapter is unpublished at this time but space has been provided for future insertion. Nevertheless, a comprehensive discussion of complex accounting topics such as pensions, derivatives and hedging, stock compensation, etc. are beyond the scope of this Manual.
6. A chapter discussing sample financial statements is provided to provide general guidance on the financial statement reporting model a credit union under \$10 million in assets may wish to adopt.
7. The Manual has been targeted to accounting-specific topics thus many managerial discussions have been eliminated from the Manual.
8. The Draft Manual will be posted on the Web for approximately 6-months prior to formal publication. Comments or suggestions for changes may be posted to E&Imail@ncua.gov.

ACCOUNTING MANUAL FOR FEDERAL CREDIT UNIONS

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ACCOUNTING MANUAL FOR FEDERAL CREDIT UNIONS

NEW REVISED EDITION

A recent change in the statute governing credit union financial reporting has necessitated and hastened this revision to the existing *Accounting Manual for Federal Credit Unions*.

Section 201(a) of the Credit Union Membership Access Act (CUMAA), Public Law 105-219, 112 Stat. 918 (1998), added a new subsection to section 202(a)(6) of the Federal Credit Union Act (FCUA), 12 U.S.C. 1782(a)(6)(C). Subsection (C) addresses accounting principles, generally requiring credit unions having assets of \$10 million or more to follow generally accepted accounting principles (GAAP) in all reports or statements filed with the NCUA Board. 12 U.S.C. 1782(a)(6)(C). The NCUA Board, and State credit union supervisors under applicable statutes, are given the authority to require credit unions having less than \$10 million in assets to follow GAAP. 12 U.S.C. 1782(a)(6)(C)(iii).

In the Federal Register: July 29, 1999 (Volume 64, Number 145)], the NCUA Board published a final rule revising §741.6 implementing the statutory mandate that Call Reports filed by credit unions having assets of \$10 million or more must be consistent with GAAP. 12 U.S.C. 1782(a)(6)(C)(i).

As a result of the statutory change and the implementing rule, **credit unions under \$10 million in assets are provided this Manual as a guide in accounting for financial transactions and reporting in accordance with regulatory accounting practices (RAP) prescribed herein. Of course these credit unions also have the option of following generally accepted accounting principles (GAAP).**

Credit unions with \$10 million or more in assets should seek the advice of an independent accountant to gain a full understanding of GAAP.

PURPOSE AND USE AS A PRESCRIBED SYSTEM

This manual sets forth comprehensive procedures for the maintenance of accounting records by federal credit unions with under \$10 million in assets. It also contains accounting guidelines and requirements for accounting topics of interest such as investments in credit union service organizations, interest method of amortization, securities, repossessed property, share drafts, credit cards, etc.

This Manual is not incorporated by reference in the NCUA Rules & Regulations (R&Rs). However, adherence to the accounting principles and standards in Section 200 of this Manual will ensure

compliance with the full and fair disclosure requirements of the R&Rs which:

- Define the required level of disclosure needed on financial statements;
- Require federal credit unions to select an accounting basis that is described in this Manual; and
- Instructs credit unions to prepare financial statements in the manner prescribed in this Manual or its equivalent financial statements.

The remainder of the Manual is intended to provide guidelines to credit union officials and employees with information on recommended procedures and practices.

For the most part, the manual adheres to generally accepted accounting principles (GAAP) except for certain intentional regulatory accounting practices (RAP) which differ from GAAP.

The manual may be adopted by federally insured, state chartered credit unions under \$10 million in assets at the option of the credit unions and their state supervisor.

LOOSE-LEAF SYSTEM - PERIODIC REVISIONS

The manual is designed as a loose-leaf system to facilitate updating. When revisions become necessary, revised pages will be issued, accompanied by appropriate explanations and instructions for updating your manual.

ELIMINATION OF THE RECOMMENDED CREDIT UNION CHART OF ACCOUNTS

Credit unions are required to file periodic (quarterly or semi-annual) call reports with the National Credit Union Administration (NCUA). The credit union's accounting system and its supporting chart of accounts must facilitate reporting on the call report. Consequently, it is NCUA's contention that the call report reporting format and requirements should drive the credit union's financial reporting mechanism rather than the *Accounting Manual* chart of accounts, though familiar to credit unions.

Trying to keep the two NCUA systems uniform, compatible and current was administratively unworkable. Accordingly, the recommended and familiar *Accounting Manual* chart of accounts is being eliminated in favor of a charting system of the credit union's own design which best facilitates its compliance with the current and existing call reporting requirements.

CREDIT UNION OPERATIONS GOVERNED BY LAWS, BYLAWS AND REGULATIONS

Federal credit unions are corporations organized and operated under the provisions of the Federal Credit Union Act (Act). They are corporations with powers limited to those granted by their charter and the Act. They are governed by their bylaws and the regulations issued by the National Credit Union Administration (NCUA). All directors, officers, and committee members should have a general knowledge of these laws, bylaws, and regulations, and a specific knowledge of the duties required of the particular office held.

ACCOUNTING PRINCIPLES AND STANDARDS -- PURPOSE AND SCOPE

Accounting by federal credit unions serves many internal and external purposes. Comprehensive and accurate financial information is essential so that credit union management can make sound decisions concerning the operation of the credit union. Management must also account for its actions to members, creditors, the National Credit Union Administration in its supervisory capacity, and others having valid financial interests.

Financial information provided to management is summarized in credit union financial statements which are intended to present fairly the financial position of the credit union at a given date, and the results of its operations for a given accounting period. The financial information so presented must be supported by accounting records maintained in conformance with principles and standards designed to provide full and fair disclosure of all material information relating to the credit union's operations.

The principles and standards of federal credit unions have been designed to follow practices in use by other financial and lending institutions and are generally based on generally accepted accounting principles (GAAP) as developed by the accounting profession. Use of these principles by credit unions for their accounting and financial reporting will provide for full and fair disclosure of financial information.

Many of the principles and standards require the exercise of judgment by credit union officials where optional courses of action are available or where estimates are required for application of a particular principle. Also, direction is necessary under the doctrine of materiality (See Section 200) in order to evaluate the need for applying a particular principle to specific transactions or situations. Subject to these qualifications, the principles and standards in this section of the Manual must be followed to comply with the full and fair disclosure requirements of the Rules and Regulations.

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ACCURATE AND CURRENT RECORDS ESSENTIAL

PURPOSE OF RECORDS

The transactions of the credit union are compiled in its records which serve as a source of information needed by the directors to properly manage the credit union. The accounting records also serve as the basis for reports to the members and interested third parties. Therefore, it is essential that the records be accurate, current, and that they show the true financial condition of the credit union. Prompt preparation of reports will aid the credit union in achieving its objectives and fulfilling the purposes for which it was formed.

BASIC ACCOUNTING RECORDS

Bookkeeping may be defined as the systematic recording of the financial transactions of a business in a suitable form. To accomplish this, a well-defined system of accounts is necessary.

Double-Entry System

All federal credit unions should use a double-entry accounting system. In this system each transaction results in at least two entries: a debit (or entry on the left side of an account ledger) and a credit (or entry on the right side of an account ledger). If the transaction requires several debits and credits, the total of the debits and the total of the credits must be the same. In other words, for every debit entry there must be an offsetting credit entry and vice versa. Following this rule and determining that the total debits equal the total credits can keep the records in balance.

Record financial transactions as journal entries consisting of debits and credits. Every transaction affects at least two accounts. Accounting principles assign each type of account a normal debit or credit balance. The normal balance coincides with what is done to increase the balance in the account. For example, asset accounts are increased with debits; therefore, the normal balance in an asset account is a debit.

Debit refers to the left side of an account and credit refers to the right side. Calculate the account balance from the totals of the debit and credit sides of

an account and subtract the smaller sum from the larger; and the difference is called the balance of the account. Debits and credits affect asset and expense accounts in one way and liability, equity, and revenue accounts in the opposite way.

Types Of Accounts

The "Asset Accounts" record what the credit union owns. These include cash, loans, investments, etc. These accounts, as well as the expense accounts, normally have debit balances.

The "Liability Accounts" record what the credit union owes and the "Equity Accounts" reflect the member's ownership interests. Together these accounts include notes payable, members' shares, undivided earnings and reserves. The "Liability Accounts" and "Equity Accounts" as well as the income accounts normally have credit balances.

A brief general rule for debits and credits is: Debit the increase of an asset, the reduction of a liability or equity account, or the payment of an expense; credit the reduction of an asset, increase of a liability or equity account or, receipt of income.

BRIEF OUTLINE OF THE PRESCRIBED ACCOUNTING SYSTEM

The accounting records of federal credit unions should be maintained on either of two accounting bases: namely, the modified cash basis or the accrual basis. The accrual basis of accounting is recommended for credit unions with assets totaling \$2 million or more at the end of the accounting period.

MODIFIED CASH BASIS

Generally under a cash basis of accounting, income is recorded and accounted for when actually collected and expenses are accounted for when actually paid. Under the modified cash basis prescribed herein, the accounting is based on the actual receipts and disbursements of the credit union except that provisions should be made to reflect:

- Liabilities which are not promptly paid when due,
- Dividends and interest refunds applicable to the accounting period but not yet paid,
- Deferred income or expenses applicable to future periods,
- Estimated losses to be sustained on loans outstanding,
- Estimated unrealized losses associated with mutual fund investments, and
- Depreciation on fixed assets.

The foregoing exceptions to maintenance of accounting records on a strictly cash basis are designed to recognize in the accounts certain significant financial transactions not involving the concurrent receipt or disbursement of cash and to reflect their effect in financial reports prepared from the accounts. In unusual circumstances, there may be other significant non-cash financial transactions that should be recorded. Therefore, the above list is not all-inclusive.

Credit unions for which adoption of the accrual basis of accounting is not required or practicable should use the modified cash basis of accounting.

ACCRUAL BASIS

The accrual basis of accounting refers to that method under which liabilities and expenses are recorded when incurred, whether or not paid, and income is recorded when earned, whether or not received. It is intended that credit union accounting be maintained on the accrual basis by all credit unions for which they deem such basis practicable.

Generally accepted accounting principles require the accrual basis of accounting.

THE BASIC CREDIT UNION ACCOUNTING SYSTEM DESCRIBED

For credit unions following either the accrual basis or the modified cash basis of accounting, the majority of entries originate with the receipt or disbursement of cash. Other entries are relatively

few in number and consist generally of adjustments or transfers between accounts, establishment and maintenance of an allowance for loan losses, write-offs of bad loans, and recording depreciation of tangible fixed assets. In addition, credit unions following the accrual basis of accounting should make entries to record accrued income and expenses.

Records Of Original Entry And Record Of Final Entry

A bookkeeping system can be broken down into two distinct parts: Records of Original Entry (the Journal and Cash Record) and Records of Final Entry (the General Ledger). In addition, the Cash Received Voucher or its equivalent and the Journal Voucher or its equivalent serve as memorandum records of the original transactions and the sources of entries in the Journal and Cash Record.

The Records Of Original Entry

The Records of Original Entry are diaries of the transactions as they occur. The Journal and Cash Record is the main record used for this purpose. Each day's cash receipts, disbursements and other transactions are entered in the Journal and Cash Record in chronological sequence. Thus, a running history of each day's transactions are kept and may be summarized as needed.

At the end of a given period, usually the month end, the total of all transactions pertaining to each account can be obtained by totaling the debit and credit columns of the Journal and Cash Record. The accuracy of the entries can be proved in part by balancing the debit columns against the credit columns.

The Record Of Final Entry

The Record of Final Entry is the General Ledger. This record serves as a means of summarizing the entries in a form that will enable the bookkeeper to prepare reports on the results of operations to date. Entries in the General Ledger consist of posting (simply transferring) the debits and credits (either individually or in total at the end of the month) for each account in the Journal and Cash Record to the corresponding account in the General Ledger and

computing the net balance for each account. The result obtained shows the current balances of the credit union's accounts and the results of operations for the period.

Sometimes, when a General Ledger account summarizes a large number of transactions, it is necessary to provide detailed information about this account with a record known as a Subsidiary Ledger. The Individual Share and Loan Ledgers are examples of subsidiary records which show the detailed share and loan transactions with each member. The Share and Loan accounts in the General Ledger reflect the total transactions with all members. These General Ledger accounts are called Control Accounts since they act as a control or check over the numerous postings to the individual or subsidiary ledgers. Subsidiary records are balanced with related control accounts on a monthly basis and the reconciliation, or other proof of balancing, is retained.

BASIC CONCEPTS AND GENERAL PRINCIPLES

The basic concepts and general principles of the detailed accounting principles and standards for federal credit unions are:

SEPARATE ENTERPRISE

Each credit union is a separate corporate enterprise requiring the maintenance of comprehensive accounting records and financial reporting practices to provide meaningful information to members, officers, directors, the supervisory committee, the National Credit Union Administration (NCUA), and interested third parties.

GOING CONCERN CONCEPT

Each credit union should normally maintain its accounts as a "going concern" on the basis that its operations will continue indefinitely. Therefore, assets and liabilities should represent the value to the credit union as a "going concern" and should not present liquidation values.

Whenever unusual circumstances indicate a limited life for a credit union, e.g., if the credit union liqui-

dates, the "going concern" concept no longer applies. As a result, a statement of realistic assets and liabilities and appropriate revenues and expenses may require adjustments. These adjustments could include:

- Re-evaluation of the loan portfolio to recognize discounts on sales of loans,
- Evaluation of the realizable value of fixed assets in liquidation, and
- Re-evaluation of the carrying value of deferred charges and deferred credits, etc.

MONETARY BASIS FOR ACCOUNTING

State account values in terms of the dollar amounts involved at the time transactions occur. Recording each transaction in terms of dollar units provides the best feasible indicator of its relative impact on the overall operations of the credit union. It also permits identification of the amount of assets, liabilities, equity, income, or expenses represented by the transaction.

CONSISTENCY IN ACCOUNTING FROM PERIOD TO PERIOD

Follow consistent accounting practices from one accounting period to the next. Should a material change in accounting treatment occur, disclose the facts on credit union financial statements. Include the dollar effect upon the balance sheet and the changes in net income for the period. For example, if a credit union converts to the accrual system of accounting because assets exceed \$10 million, it should make a complete conversion at one time and report the conversion on the current period financial statements.

TIMELY RECOGNITION IN ACCOUNTING RECORDS

Record accounting transactions in a timely manner so all material information applicable to each accounting period shows in the records. Provide for estimated losses to be sustained in the collection or conversion of loans and other assets via charges against current expenses to properly recognize the reasonable value of assets, liabilities, and share-

holders' equity in accounting records and financial reports. Estimate amounts for accruing income or expenses if actual amounts are not known and cannot be determined readily. Absorb differences between the actual and estimated amounts in the operations of the subsequent accounting period.

MATERIALITY

Recognize material facts relating to credit union financial activity in the accounts and report them on financial statements. GAAP provides that a statement, fact, or item is material if, giving full consideration to the surrounding circumstances as they exist at the time, it is of such a nature that its disclosure, or the method of treating it, would be likely to influence or to "make a difference" in the judgment and conduct of a reasonable person. The accumulation of many small items, each of which in itself would not be "material", would be "material" if the overall effect would tend to influence the judgment and conduct of a reasonable person.

CONSERVATIVE ACCOUNTING

Maintain accounting records on a conservative basis. Make reasonable provisions in the accounts for potential losses on assets and for the settlement of liabilities. Do not materially overstate nor understate its assets, liabilities, revenues or expenses.

INTERNAL CONTROL

Adopt appropriate measures of internal control to improve the dependability of accounting records. These measures must include:

- An organization plan to provide, to the extent feasible, segregations of duties so different employees will handle the operational, custodial and accounting functions;
- A system of authorization and recording procedures adequate to provide reasonable accounting control over assets, liabilities, income and expenses;
- The employment of personnel capable of performing duties and responsibilities; and

- A supervisory committee to conduct effective and timely audits of records and accounts including verification of members' accounts, with assistance provided, where needed, by an independent auditing firm.

COMPLETE RECORDING OF INCOME AND EXPENSES

Record income, expenses, gains, and losses in income and expense accounts and show them on the Statement of Income for the accounting period. Income and expense accounts should include actual and estimated loan and other asset losses.

ACCOUNTING BASIS

GAAP requires the accrual basis of accounting because it provides the most complete and informative record of financial activities. The accrual basis refers to recording liabilities and expenses when incurred, whether or not paid, and income when earned, whether or not received. Credit unions with less than \$10 million in assets do not have to adopt the full accrual basis of accounting. The alternative method is the modified cash basis of accounting. When a credit union's assets reach \$10 million or greater, management must convert to the accrual basis of accounting.

Determine the proper accounting basis using the following guidelines:

- If assets total \$2 million or more at the end of the accounting period, adoption of the accrual basis is *recommended*;
- If the board of directors deems the accrual basis practicable, use the accrual basis;
- If following the accrual basis, credit unions with less than \$10 million in assets may apply the cash basis to particular accounts where the results would be only insignificantly different from the accrual basis. For this purpose, "insignificantly" refers to differences which would not be considered important for a proper evaluation of condition or operations of the credit union; and

- If adoption of the accrual basis is not required or practicable, use the modified cash basis. Under the modified cash basis, accounting is based upon the cash receipt and disbursement transactions except to make provision to reflect:

- a) Liabilities not paid promptly when due;
- b) Dividends and interest refunds applicable to the accounting period but not yet paid;
- c) Deferred credits and charges applicable to future periods;
- d) Estimated losses to be sustained on loans outstanding and other risk assets; and
- e) Depreciation of fixed assets.

ACCOUNTING AND DIVIDEND PERIODS

Accounting periods may be monthly, quarterly, semiannually, or annually depending on the period selected by the credit union to close its books. Each credit union must close its books at least annually at the end of the fiscal year. Federal credit unions *may choose* to close the books at the end of each regular share account dividend period unless dividends are paid more frequently than monthly.

FISCAL YEAR

The fiscal year of all federal credit unions should track the calendar year beginning on January 1 and ending on December 31.

ACCOUNTING PROFESSION PRONOUNCEMENTS

Alternatives to the accounting principles authorized by the NCUA — for certain types of transactions — are provided for adoption at the option of any credit union with less than \$10 million in assets. These alternatives provide the flexibility required for meaningful accounting under a variety of circumstances in credit unions of different size and scope of operations. *Absolute uniformity is not required so long as each credit union conforms its accounting to authorized generally accepted accounting principles.* Consistency in accounting from period

to period and disclosure of material accounting changes is necessary.

The Financial Accounting Standards Board (FASB), the Accounting Standards Executive Committee (AcSEC) of the American Institute of Certified Public Accountants (AICPA), and their committees establish generally accepted accounting principles (GAAP), accounting guidelines, and preferred accounting treatment for various activities. Credit unions should refer to such accounting profession pronouncements for guidance where a particular activity is not addressed by this manual or other NCUA publications. Credit unions may adopt such accounting profession pronouncements provided they are not inconsistent with the principles, standards, and procedures set forth herein or statutory or regulatory requirements.

Refer activities unique to credit unions and not addressed in existing accounting industry literature or in NCUA publications to an independent accountant for review and comment. Copies of the correspondence should be maintained in the credit union's files.

HIERARCHY OF GAAP STANDARDS

External sources such as the FASB issue accounting standards in multiple forms. Following is the hierarchy of standards:

1. FASB Statements and Interpretations, APB Opinions, and AICPA Accounting Research Bulletins;
2. FASB Technical Bulletins, AICPA Industry Audit and Accounting Guides, and AICPA Statements of Position;
3. Consensus positions of the FASB Emerging Issues Task Force and AICPA Practice Bulletins;
4. AICPA accounting interpretations, "Qs and As" published by the FASB staff, as well as industry practices widely recognized and prevalent; and
5. Other accounting literature, including FASB Concepts Statements; AICPA Issues Papers; International Accounting Standards Committee Statements; GASB Statements, Interpretations, and

Technical Bulletins; pronouncements of other professional associations or regulatory agencies; AICPA Technical Practice Aids, and accounting textbooks, handbooks, and articles.

HIERARCHY OF REGULATIONS

The NCUA issues guidance in multiple forms. As management refers to the various forms of guidance, it is important to utilize the hierarchy of regulations:

1. Federal Credit Union Act,
2. NCUA Rules and Regulations,
3. NCUA Interpretive Ruling and Policy Statement (IRPS) – if the IRPS was issued "for notice and comment", it has the same force as the NCUA Rules and Regulations, and
4. All other forms of regulatory guidance including:
 - Federal Credit Union Bylaws,
 - NCUA Letters to Credit Unions,
 - NCUA Instructions,
 - The NCUA Accounting Manual, and
 - NCUA General Counsel Opinions.

GENERAL LEDGER, SUBSIDIARY LEDGERS, AND ACCOUNT RECONCILIATIONS

CHART OF ACCOUNTS

Federal credit unions must design their own chart of accounts. Management is responsible for reporting financial information to the NCUA on the periodic Call Report. Therefore, we recommend the credit union's chart of accounts closely mirror the Call Report for ease of reporting. Use the prescribed financial report forms in Section 900 as a guide for financial reports intended for posting to members.

Whatever chart of accounts numbering system management adopts for its general ledger accounts, it should permit the classification of transactions in at least the detail required to properly complete the NCUA call report forms.

GENERAL LEDGER

The general ledger is a comprehensive record of individual accounts on the chart of accounts. The chart of accounts is a listing of general ledger account numbers and account names. The general ledger accounts contain entries pertaining to a specific asset, liability, equity, income, or expense. Some computer systems will print various levels of detail for general ledger reports. Subsidiary ledgers and account reconciliations support the general ledger.

SUBSIDIARY LEDGERS

Subsidiary ledgers store the details of certain general ledger accounts. Subsidiary ledgers support general ledger accounts. Use of subsidiary ledgers may reduce the number of general ledger accounts. The fewer the number of accounts, the easier it is to avoid errors and find them when they occur. Subsidiary ledgers are often set up for loans, cash, investments, prepaid expenses, fixed assets, shares, equity, income, and operating expenses. The better the system of organizing account details in subsidiary ledgers, the easier it is to avoid errors and find them when they occur.

ACCOUNT RECONCILIATIONS

Account reconciliations prove account balances on a regular basis. Staff will typically prepare these at least monthly. Accounts such as corporate investments may require reconciliation weekly or daily. Reconciliations are not necessary for all accounts. Management's written policy or procedures will guide staff to complete reconciliations appropriate for the credit union.

PRINCIPLES AFFECTING THE RECORDING OF ASSETS

UNDER THE MODIFIED CASH BASIS OF ACCOUNTING

The principles and standards of accounting relating to assets of federal credit unions following the modified cash basis of accounting are set forth below.

Assets – General Basis for Recording

Record assets at their cost to the credit union, normally. There are some exceptions to this rule, e.g., available-for-sale and trading securities.

Cash – Unrestricted or Restricted

Record *restricted* cash on deposit or on hand in separate accounts from other cash accounts. Show each category of *restricted* cash separately on financial reports, other than change funds or petty cash.

Loans

Record the unpaid balances of loans outstanding and other receivables. Maintain appropriate valuation allowance accounts to cover estimated losses. Under the accrual basis of accounting, amortize net loan origination fees and costs over the life of the related loans using the interest method. Under the modified cash basis of accounting, at a minimum, amortize origination fees over 10 years or the life of the loan, whichever period is shorter.

Investments

Record investments and related transactions based on the principles and standards described below. Generally, depository instruments are recorded at amortized cost while securities are recorded as follows:

- Classify *debt and equity* securities purchased and held principally for the purpose of selling them in the near term as *trading securities* and report at fair value through the income statement.
- Classify *debt* securities (not equity) management has the positive intent and ability to hold to maturity as *securities held-to-maturity* and

report at amortized cost, i.e., cost adjusted for the amortization of premiums or the accretion of discounts.

- Classify *debt and equity* securities not classified as either *trading* or *held-to-maturity* securities as *securities available-for-sale*. Report at fair value through a separate component of equity in the balance sheet, *Accumulated Unrealized Gains/Losses on Available-for-Sale Securities*, an item of Other Comprehensive Income.
- Amortize *premiums paid for securities* using the interest method by periodic entries offsetting income on investments over the period from acquisition to maturity. Record amortization on a timely basis corresponding to the recording of the related income. If interest on investments is recorded at the time the income is received by cash payments, record the premium amortization similarly.
- Record *discounts on securities* using the interest method as income over the period from acquisition to maturity by periodic entries augmenting income from investments. Coordinate entries to record the write-off of discounts with the recording of the related income.
- Record *income earned on investments* as income when received. An exception is income automatically reinvested in common trust investments, marketable equity securities, bank passbook accounts, savings and loan shares, which should be recorded as an increase in the carrying value of the investments when notice of income credits are received by the credit union; the offsetting credit should be to income from investments; and
- Record *accrued interest purchased on bonds and securities* as an asset and clear it by an offset against interest received when the first interest payment on the related securities is received.

Refer to Section 300 of this manual for more detailed information regarding investments.

Fixed Assets

Record fixed assets in accordance with the following principles:

- Record *acquisitions of tangible fixed assets* at cost. The acquisition cost is the net purchase price of the asset plus all incidental costs necessary to put the asset in condition for use, such as freight and installation cost. If management exchanges property for an asset, record cost as the amount of cash paid plus the recorded amount of the asset surrendered. Do not recognize a gain, if any, on the transaction; do recognize the entire loss on the exchange, if any. If management acquires property via exchange without cost, use the fair market value as the "cost";
- Establish a dollar value limit, i.e., \$250, under which management records tangible property purchases as current expense even though the items may be serviceable for more than 1 year;
- Show cost of land (and land improvements) separately from the cost of the buildings and other improvements. In combination purchases, record the cost of land based on a fair market value estimate;

Depreciation

Fixed asset depreciation is a system of distributing the cost and other basic values of fixed assets less salvage over the estimated useful life of the unit (which may be a group of assets) in a systematic and rational manner. Record depreciation in each accounting period by debiting expense and crediting valuation allowance accounts under either of two bases:

- Use the *unit depreciation basis* to record depreciation over the estimated useful lives of assets based on the cost of the assets less estimated salvage value. For assets having a remaining use, the depreciation shall not exceed the carrying value of the asset less:

- a) the salvage value, or
- b) \$1.00.

Maintain a depreciation record for each depreciable item. Management may use either the straight-line, declining balance, or the sum of years' digits methods for the purpose of computing the periodic amounts of the depreciation to be charged; and

- Under the *composite basis*, record depreciation continuously based on established composite rates. The accumulated depreciation allowance account under the composite-life method of depreciation cannot exceed the related fixed assets account.

Prepaid Expenses and Deferred Charges

Record costs affecting subsequent accounting periods as prepaid expenses, if material in amount, and amortize them over the accounting periods to which applicable. Examples include insurance premiums, stationery and supplies, advances for accounting services, annual share insurance premium, NCUA operating fee, and organization costs. Amortize deferred organization costs over a period not extending beyond the year incurred and the two subsequent fiscal years.

Assets Pledged

Disclose the nature and extent of credit union assets pledged to secure debts in the financial statements.

UNDER THE ACCRUAL BASIS OF ACCOUNTING

Apply the principles and standards of the modified cash basis of accounting except as noted below.

Income on Loans

Accrue interest earned each month or dividend period on loans outstanding, as a debit to assets and a credit to income. Do not accrue interest on loans 3 months or more delinquent.

Income on Investments

Accrue income on investments each month or dividend period based on the time the investments were held and the income was not received.

Amortization of Premium or Discount on Securities Purchased

Whether management accrues interest on investments monthly, quarterly, semiannually, or annually, record the premium amortization based on the same time periods. Likewise, accrete discounts on securities via periodic entries increasing accrued income from investments. Record entries to write-off the discount within the same periods of time.

PRINCIPLES AFFECTING THE RECORDING OF LIABILITIES

UNDER THE MODIFIED CASH BASIS OF ACCOUNTING

Liabilities – General Basis for Recording

Record known liabilities at their actual amounts or, if the actual amounts are not known, record them based on reasonably accurate estimates.

Accounts Payable

Record all bills due and unpaid as accounts payable if not paid before the end of the period.

Notes Payable

Record funds borrowed to show the outstanding amount payable on the notes. Include balances of senior liens on assets repossessed or foreclosed where the credit union acquires title subject to the prior liens.

Accrued Interest Payable

If management records accrued interest, the offsetting charge is the expense account, Interest on Borrowed Money. Recording accruals of interest due on notes payable is not required.

Dividends Payable

Upon declaration of a dividend, record the actual or estimated amount payable as a liability unless the dividend is paid or credited to share accounts in the

last month of the dividend period. Offset the charge to Dividend Expense or Accrued Dividends Payable.

Interest Refund Payable

Upon declaration of an interest refund, record the actual or estimated amount payable as a liability unless the refund is paid or credited to share accounts in the last month of the dividend period. Offset the charge to Interest Refunds. Management may record estimated interest refunds monthly.

Accrued Expenses

When expenses are not paid promptly, accrue them as liabilities and debit expenses. When disbursement takes place, reverse these liabilities. Except for dividends, credit unions following the modified cash basis are not required to accrue expenses and allocate the costs to the periods benefited.

Accrued Dividends

Whenever management specifies or contracts a dividend rate on any type of account in advance, accrue the expense monthly or at the end of the shortest dividend period offered by the credit union on any type of account. The only exception to this rule is, accruals are never required more frequently than monthly.

Dividends in any dividend period cannot exceed:

- a) Undivided earnings available at the beginning of the period;
- b) Plus — net income (or less net loss) before dividends for the current dividend period.

Deferred Credits

Deferred credits include discounts on FHA loans and discount on loans purchased from other credit unions. Record deferred credits separately and amortize by crediting income during subsequent periods as the income is earned. Report the amounts of discounts on loans recorded as deferred credits as deductions from the related asset accounts in financial reports.

Liabilities Secured by Liens

Report the nature and extent to which particular liabilities are secured by a lien on assets on the financial statements.

Contingent Liabilities

A contingency is an existing condition, situation, or set of circumstances that may or may not result in a gain or loss to the credit union. The amount of the resulting gain or loss will be determined by future event(s). Accrue the amount of a contingent loss by charges to expense if:

- Prior to issuing financial statements, it is probable a loss will actually occur because an asset was impaired or a liability was incurred on the date of the financial statements; and
- Management can make a reasonable estimate of the resulting loss.

Note: Estimate the amount of the accrued contingent loss realistically based on all information available. If some amount within a range appears at the time to be a better estimate than any other amount within the range, that amount shall be accrued. If no amount within the range is a better estimate than any other amount, however, the minimum amount in the range shall be accrued.

If both of the above conditions are not met but a reasonable possibility exists that a loss may have been incurred, or if the estimated amount is not material, a contingent loss need not be accrued but disclosed as a note to the financial statements.

Examples of contingent liabilities are pending or threatened litigation, selling loans with recourse, guarantees of the indebtedness of others, and agreements to repurchase assets sold previously.

UNDER THE ACCRUAL BASIS OF ACCOUNTING

The principles and standards applicable to the modified cash basis of accounting apply under accrual basis of accounting, except as follows.

Accrued Interest Payable

Record in each month or dividend period the accrued interest payable on notes and mortgages with an offsetting debit to interest expense.

Accrued Expenses

Examples of accrued expenses are dividends and salaries. Accrue expenses to allocate costs to the periods benefited. Record the accruals normally each month or dividend period so all significant expenses are shown on financial reports provided to directors and members.

PRINCIPLES AFFECTING EQUITY**NET INCOME**

The net income or loss for the current accounting period should represent the difference between all income and expense items.

UNDIVIDED EARNINGS

At the close of each accounting period, close the income and expense accounts into the Net Income (Loss) account. Then transfer the balance of the Net Income (Loss) account to Undivided Earnings.

Debit or credit undivided earnings with amounts required to establish or adjust other appropriation accounts, including the appropriation for loss contingencies or the special appropriation for losses established when so ordered by the NCUA Board. Other direct charges or credits to undivided earnings only include error correction for material amounts which represent adjustments affecting prior accounting periods. Material errors in such financial statements could include arithmetic mistakes, the misuse or deletions of information, mistakes in the applications of accounting principles or procedures, and improper interpretations of the accounting aspects of major transactions. Error correction should not result in the restatement of the prior year's financial statements to disclose the error correction but should be reflected in current period financial statements and those going forward.

Do not treat normal recurring corrections and adjustments which are the natural result of the use of estimates inherent in the accounting process as prior-year adjustments. Normal recurring corrections include changes in estimated loan losses, accumulated depreciation on disposed assets, and estimated dividends. These changes are properly recorded as transactions affecting the current year in the appropriate income and expense accounts. The determination of net income for the period must include all items of profit and loss recognized during a period, including accruals of estimated loss from loss contingencies.

DIVIDENDS

Declare and pay dividends to shareholders from current income, plus any available balances of undivided earnings. Charge the dividends as a current year expense. Management should use caution in expending undivided earnings to meet current operating expenses, particularly for payment of above market dividends. Rather, credit unions should strive to build capital.

APPROPRIATION FOR LOSS CONTINGENCIES

Management can establish an appropriation for contingencies for possible or unforeseen decreases in the value of assets or for other unforeseen or indeterminate liabilities not otherwise shown on the credit union's records. Any such appropriation established only as a precautionary measure will represent a segregation of undivided earnings and should be so classified in financial reports. Do not use contingency appropriations as a substitute for valuation requirements for the amount of currently estimated losses on loans or other assets. When the net loss during any accounting period exceeds available undivided earnings, reduce the appropriation for loss contingencies and/or other segregations of undivided earnings to offset such excess.

Even if management established an Appropriation for Loss Contingencies for a particular liability or expenditure, do not charge such expenditures directly to the appropriation. Record the loss or cost as an operating expense.

Establish the Appropriation for Loss Contingencies for a particular event by a debit to Undivided Earnings. When the event occurs, or the liability is paid, credit the balance of the account back to Undivided Earnings. Transfers from the Appropriation for Loss Contingencies to Undivided Earnings must be in amounts equal to costs charged to expenses during an accounting period, thereby eliminating any reduction in Undivided Earnings which would have occurred due to the contingency taking place.

DONATIONS

GAAP affects how credit unions with \$10 million or more in assets measure and disclose donated assets and services on their financial statements. Credit unions under \$10 million in assets may follow GAAP or Regulatory Accounting Principles (RAP). Regardless of the method used, management must consistently apply the method they choose, GAAP or RAP, as outlined in this section.

From a RAP perspective, NCUA considers the donation of assets and services from a sponsor to a credit union as a reciprocal transfer (i.e., in return, sponsor gets the fringe benefit to employees of on-site financial services). Thus, management does not have to report the donation of assets and services by the sponsor on their financial statements. From a GAAP perspective, management must recognize the fair value of the contributed use of facilities or other services as both a revenue and an expense in the period received and expended.

Under GAAP, record donations and gifts received (including donations made for the specified purpose of enabling the credit union to pay dividends) as income and show them as part of net income for the current month. RAP provides as an exception to the foregoing, if a credit union receives a gift of a tangible fixed asset of substantial value (i.e., a building or a computer) in order to exclude such amounts from current income and undivided earnings, offset the entry for the fair market value of the asset recorded in the fixed asset account to Donated Equity. Depreciate these donated assets via charges to expense over their remaining useful lives.

GAAP requires inclusion of all contributions made or received in expense/income when made/received. Contributions include many of the “donations” credit unions receive (i.e., office space, telephone services, data processing support); and some volunteer services (i.e., some accounting/auditing services, some legal advice, etc.). Under GAAP:

- Recognize some contributions simultaneously received and used as both a revenue and an expense in the period received and used (i.e., sponsor-contributed utilities); and
- Treat contribution of office space as above (i.e., revenue and expense) as long as the sponsoring entity could discontinue providing the space at any time. If the sponsoring entity provides the facility for a specified period of time (i.e., 5 years), the promise must be set up as a receivable at its fair value.

Recognize contributed services as both a revenue and an expense if the services received:

- 1) Create or enhance non-financial assets, or
- 2) Require specialized skills, are provided by individuals possessing those skills, and are typically purchased if not donated.

For example, if the above two conditions are met, GAAP requires recognition of an audit performed by uncompensated Supervisory Committee members as a revenue and an expense on the credit union's books.

SHARES AS EQUITY

Classify shares as equity in the Statement of Financial Condition:

- The Federal Credit Union Act, as amended by the Competitive Equality Banking Act (CEBA) of 1987, legally defines shares as equity;
- Shares function as equity and represent ownership; and
- Share dividends are based on earnings and are not guaranteed.

In some jurisdictions, boards of directors may allow individual members to deposit more than the member's ownership interest. In these cases, management should properly classify excess shares as liabilities on the Statement of Financial Condition.

PRINCIPLES AFFECTING THE RECORDING OF INCOME AND EXPENSES

UNDER THE MODIFIED CASH BASIS OF ACCOUNTING

The principles and standards of accounting relating to income, expenses, gains, and losses of federal credit unions following the modified cash basis of accounting are set forth below.

General Rules for Recording Income and Expenses

Record all income, expenses, gains, and losses affecting each accounting or dividend period through income and expense accounts. To correct an error affecting prior accounting period operations, refer to GAAP.

Basis for Recording Income

Record income periodically as received. Record fees and late charges as income when received.

Basis for Recording Expenses

Expenses are the uses and consumption of goods and services in the process of producing income. Pay and record expenses related to current operations promptly when due. Record all expenses incurred but not paid at the end of the month as current month expenses: as accounts payable or accrued expenses. Record significant amounts of expenses paid or accrued if applicable to future periods as prepaid or deferred expenses and amortize them over the periods to which they apply.

Tangible Fixed Asset Expenses

Expense depreciation of fixed assets over the useful lives of the assets under the unit or the composite basis.

- When management computes depreciation on a unit basis, eliminate the amount of the retired asset together — including any related depreciation allowance. Record any material difference between the net amount realized from disposition and the net carrying value of the depreciable assets as an "other gain or loss" and show it in financial reports separate from regular operating income or expense; and
- When management computes depreciation on a composite-life basis, credit the cost of retired units to the appropriate fixed asset account; charge the same amount less salvage value to the allowance for depreciation account. Do not recognize gain or loss in the accounts since items in the group will retire both before and after expiration of the estimated average life. When retirements are abnormal or unusual, record gains or losses in the accounts, similar to the unit basis since composite rates do not anticipate such retirements.

Amortization of Deferred Charges

Examples of deferred charges include prepaid insurance, leasehold improvements, and organization expenses. Include debits in expenses each month or dividend period for amortization of deferred charges.

Equipment Rental Expense

Charge rental charges under equipment leases directly to expense unless they represent installment purchases of fixed assets. If a rental agreement represents an optional purchase contract the credit union plans to exercise by purchasing the equipment, record the cost of the equipment as a fixed asset and a liability. Thereafter, payments made will reduce the liability amount, and management will record appropriate depreciation expense. Refer to GAAP for further guidance.

Loan Losses

Record losses on loans and related assets as described below:

- Charge off loan losses as they occur, with the approval of the board of directors, by debits to Allowance for Loan Losses. Record recoveries on loans charged off, as they occur, as credits to Allowance for Loan Losses;
- Establish and maintain Allowance for Loan Loss to reflect the estimated amount of losses on:
 - (1) Originated member loans.
 - (2) Loans purchased from other credit unions.
 - (3) Lease receivables.

The value of the allowance account should be adjusted monthly or at the end of the regular share dividend period, if longer than monthly. For this purpose, management should determine the amount of the allowance adjustment based on a logical, documented, defensible method which will result in the estimation of all probable losses inherent in the loan portfolio as a given date, and (losses) which are reasonably estimable.

Other Gains and Losses

Normally include other gains and losses when determining periodic net earnings or losses. Report non-recurring gains or losses (those unrelated to ordinary credit union activities) separately as non-operating income or expense on periodic income and expense statements. For example, charge a gain or loss from the sale of a credit union office building, and any loss charged off on a note or contract taken in connection with a sale of credit union office quarters to Other Losses.

Cash Overage and Shortages

Record cash overages and shortages from the processing of cash transactions as debits or credits to expense daily. Adjust the cash over and short expense accounts whenever the reason for the cash overage or shortage is determined. Consider any

overage or shortage in negotiable instruments a "cash overage or shortage" and record the appropriate adjustment at least prior to the close of each month.

Donations

Refer to the discussion in Principles Affecting the Recording of Equity.

Pension Plan Costs

Pension plan accounting is beyond the scope of this publication. Seek assistance from an independent accountant.

NCUA Insurance Guaranty

Do not record any guaranty provided by the NCUA to a credit union to make it insurable under Title 11 of the Federal Credit Union Act, as amended. This guaranty represents a claim by the credit union against the NCUA which is payable only in the event of liquidation of the credit union and then only to the extent needed to reduce or eliminate loss claims against the Title 11 share insurance fund. Amortize guaranties through charges to expense in accordance with the terms of the guaranty agreement.

UNDER THE ACCRUAL BASIS OF ACCOUNTING

The principles and standards of accounting applicable to the modified cash basis of accounting apply under the accrual basis of accounting, except as follows:

Income on Loans

Record interest income earned each month or dividend period on loans outstanding as income and as an asset although it may not have been received. Many computerized loan systems will calculate the amount to accrue. Maintain supporting documentation for the accrual.

Income on Investments

Management should record income as noted:

- Record income for investments in savings and loan associations and other credit unions in each month or dividend period the investments are held and the interest or dividend income was not received. For example, accrue the amount of each quarterly or other distribution applicable to each dividend period as Accrued Income on Investments with an offsetting entry to Income from Investments;
- Record income for mutual fund and common trust investments as income for the month or dividend period based on the time the investments are owned. Adjust the amount each month or dividend period as required based on the change in value. If management receives income during the period, record the amount as the actual amount of interest earned for the preceding period;
- Record income for other investments each month or dividend period based on the actual time the investments are held and interest or dividend income was not received. Recognize the amount earned as income and as an asset. Accrue interest earned on the general type of government securities each month or dividend period based on the applicable portion of the semiannual interest. Accrue interest on appreciation-type savings bonds in each month or dividend period based on the pro rata amount of the bond appreciation for the period shown on the bond's table of redemption values. Accrue interest on loans to other credit unions, certificates of deposit and deposits in other credit unions to record interest earned each month or dividend period based on the actual time the investments or deposits are held; and
- Record differences between the amount of income accrued and actual income in the appropriate accounts when income is received.

Accrued Expenses

Expense accruals include, but are not limited to, charges to expense for unpaid salaries, uncompensated leave, dividends, supervisory committee audit, taxes, and interest on borrowed funds. Pay or accrue expenses and match them against peri-

odic revenues with offsetting credits, where necessary, to cash, payables, or accrued expenses.

Accrued Interest on Loans Included in Valuation Allowance

Include an amount to cover potential losses on accrued interest receivable from loans in the valuation allowance for estimated losses on outstanding loans. Do not accrue interest on any loans 3 months or more delinquent. Reverse previously accrued interest on such loans via appropriate entries to Accrued Interest and Interest Income.

FINANCIAL STATEMENTS

PURPOSE

Federal credit unions' financial statements must present their financial position fairly as of a particular date. This is the most important external function of the accounting process. Financial statements must be posted in a conspicuous location for the information of members at each credit union location and as required by the NCUA. The results of operations for a particular period must follow GAAP if assets are \$10 million or more. Other credit unions may follow GAAP and must follow the principles prescribed herein. Management uses financial statements to:

- Make sound decisions,
- Effectively manage the credit union, and
- Show how management has carried out its stewardship to shareholders, creditors, and others having an interest in the credit union.

REQUIRED STATEMENTS

Management must prepare two financial statements every month for internal and external use. These statements are:

- Statement of Financial Condition, and
- Statement of Income.

Statement of Financial Condition

The Statement of Financial Condition (balance sheet) and notes thereto should show the financial condition of the credit union as of the date it represents. The statement should:

- Recognize the basic concepts of the principles and standards of accounting by showing, on a conservative basis, assets and liabilities including contingent losses, appropriate classifications of credit union equity; and identify any significant changes in the supporting accounting practices from those used in the previous presentation;
- Provide valuation allowances as deductions from related assets to show estimated amounts of losses as well as depreciation on tangible assets. Management should include estimated losses to be sustained in collateral collection or value realization;
- Separate unrestricted cash and restricted cash, and identify the nature and extent of any assets pledged or hypothecated;
- Reflect the nature and extent to which specific liabilities are preferred liens on assets; i.e., indicate for any real estate mortgage the particular assets pledged as security;

Statement of Income

This statement and notes thereto should reflect all income, expenses, gains, and losses of the credit union for the period for which prepared. It should:

- Reflect the results of operations in accordance with GAAP or at a minimum, the principles prescribed herein;
- Segregate regular operating income, expense, gains, and losses from any extraordinary income, expense, gains, or losses;
- Include within regular operations, increases and decreases in the valuation allowance established for estimated losses on loans and loan assets; and

- Include as income all fees and charges made to members and borrowers.

Notes To Financial Statements

The objective of notes to financial statements is to provide information not sufficiently described within the body of the financial statements. Notes to financial statements are an integral part of the statements and should provide:

- a) A description of significant accounting policies followed;
- b) An explanation of changes in methods or techniques of handling accounting transactions;
- c) An explanation of creditors' rights to specifically pledged assets;
- d) A disclosure of contingent assets and liabilities, restrictions on dividend payments, and executory contracts; and
- e) The market value of investments.

Disclosures About Fair Values of Financial Instruments

Credit unions with less than \$10 million in assets may wish to disclose, either in the body of the financial statements or in the accompanying footnotes, the fair values of financial instruments on their statements of financial condition. GAAP generally exempts all entities with assets of \$100 million or less from fair value disclosure requirements.

The disclosure may be advisable for all financial instruments, both assets and liabilities, recognized and not recognized in the statement of financial condition, *for which it is practicable to estimate fair value*. Refer to GAAP for guidance. It details procedures for estimating the fair value of "financial instruments" and illustrations for applying the disclosure requirements about fair value of financial instruments. For those affected credit unions, we recommend management obtain a copy of GAAP and prepare a financial statement footnote including the methods for establishing the fair

value of the assets, liabilities, and equity. These methods should provide the basis for the dollar estimates of the fair value. Retain historical records of your fair value calculations based on these methods and maintain an overall policy documenting these methods. If it is not practicable to estimate the fair value of a particular financial instrument, disclose in the footnote the pertinent characteristics of the instrument and the reason for impracticability of setting a fair value (i.e., it would be excessively expensive to estimate).

Federal credit unions must provide fair value information on the quarterly/semiannual NCUA Call Reports. Include fair value information on the statement of condition as management and the independent auditing firm agree (i.e., if you are seeking an unqualified opinion).

OPTIONAL STATEMENTS

The following statements are optional for credit unions under \$10 million. Post these statements with the required statements if management prepares them. Prepare the first two on a quarterly basis or at the end of the regular share account dividend period (if the dividend period is longer than quarterly). Prepare a Statement of Cash Flows at least annually:

- Statement of Members' Equity,
- Statement of Other Comprehensive Income (can be combined with Statement of Equity), and
- Statement of Cash Flows.

Statement of Members' Equity

This statement and notes thereto should show changes in total earnings during the period reported. At management's option, prepare this statement quarterly or at the end of the regular share account dividend period (if the period is longer than quarterly) and present it with other financial statements.

Statement of Other Comprehensive Income (can be combined with Statement of Equity)

Credit unions with more than \$10 million in assets may complete this statement quarterly or at the end of the regular share account dividend period (if the period is longer than quarterly) and present it with other financial statements. Management prepares this statement to report a measure of all changes in equity resulting from recognized transactions and other economic events of the period other than transactions with owners in their capacity as owners. This statement must accomplish two objectives:

- a) Classify items of Other Comprehensive Income by their nature in a financial statement; and
- b) Display the accumulated balance of Other Comprehensive Income separately from Retained Earnings and Additional Paid-in Capital in the equity section of a Statement of Financial Condition.

Other Comprehensive Income is total non-owner changes in equity during a period from transactions and other events and circumstances. It includes all changes in equity during a period except those resulting from investments by owners and distributions to owners.

Statement of Cash Flows

This statement provides relevant information about cash receipts and cash payments during the reporting period and supplements the Statement of Financial Condition and the Statement of Income. At management's option, prepare the Statement of Cash Flows at least annually under the accrual basis of accounting. Management may prepare the statement more frequently. Federal credit unions not using the accrual basis of accounting may prepare this statement.

The Statement of Cash Flows, when used with the related disclosures and other financial statements, should help to assess:

- a) Management's ability to generate positive future cash flows;
- b) Management's ability to meet its obligations, pay dividends, and determine its need for external financing;

c) Reasons for differences between net income and associated cash receipts and cash payments; and

d) Effects on the credit union's position of both its cash and non-cash investing and financing transactions during the reporting period.

More information pertaining to the Statement of Cash Flows, and its preparation and illustrations are found in Section 900 of this manual.

FULL AND FAIR DISCLOSURE REQUIRED

The financial statements described above shall provide full and fair disclosure of all assets, liabilities, appropriations, and retained earnings. A limited number of valuation allowance accounts may be necessary to fairly present all income and expenses and the overall financial position for the reporting period.

FULL AND FAIR DISCLOSURE DEFINED

"Full and fair disclosure" is the level of disclosure a reasonable person would provide to a member of a credit union, a creditor, or the NCUA in order to fairly inform them of the financial condition and the results of operation. Management provides full and fair disclosure by preparing financial statements consistent with this accounting manual or GAAP as long as GAAP is not inconsistent with regulatory requirements.

REQUIRED CERTIFICATION

When presenting financial statements to members, creditors, and the NCUA, include a declaration by the treasurer and the president that the report is true and correct to the best of their knowledge and belief, and presents fairly the financial position and the results of operations for the reporting period. In the absence of the president, any other officer designated by the board of directors may make such declaration.

DEFINITIONS OF TERMS (presented alphabetically)

Unless the context requires otherwise, the following terms have the meaning indicated in this section:

Accrual Basis of Accounting matches financial statement recognition with the period of occurrence. Under this basis of accounting, management records income when earned and expenses and liabilities as incurred regardless of the actual receipt of payment or disbursement.

Accrued Interest refers to Interest earned on loans, investments, or notes or mortgages payable, which has not been received or paid by the credit union. Management may accrue interest periodically on a time period consistent with the financial statements.

Amortization refers to the systematic write-down of prepaid and deferred expenses over a predetermined period of time, such as the write-down of an insurance premium or bond premium.

Collateral refers to real or personal property pledged as partial or full security on a debt including completed documentation for repossession and sale of the collateral in the event of default. A co-maker may be accepted in lieu of collateral to further secure a debt.

Composite Depreciation Basis refers to depreciating a group of fixed assets using a rate based on the estimated average useful lives of the assets. No depreciation is recorded when the accumulated depreciation allowance equals the book value of the fixed assets.

Deferred Charge or Deferred Expense refers to an expenditure not recognized as a cost of operations during the period incurred, it is carried forward and written off in one or more future periods. Often it includes prepaid expenses such as insurance premiums, stationery, and office supplies.

Deferred Credit refers to revenue or income received or recorded before it is earned. It includes income held in suspense until:

- Determination and deduction of offsetting charges,

- Completion of a period of time (such as collection of a related doubtful receivable), or
- Identification occurs.

Donated Equity is a regulatory accounting term that refers to equity in a credit union arising from contributions of real or personal tangible property (fixed assets).

Appropriation for Loss Contingencies refers to an appropriation of accumulated earnings set aside for possible decreases in the book values of assets or other undetermined liabilities not otherwise reflected on the books. Establish contingency appropriations as a precautionary measure only and include as a part of equity, as they represent isolations (appropriations) of undivided earnings.

Undivided Earnings refers to accumulated post-closing accumulated net income after distributions to members, adjustments affecting prior period operations, appropriations required by law, and appropriations authorized by the credit union board.

Valuation Allowance refers to an account representing management's judgment as to possible loss or decline in value within a specific class of assets such as loans or fixed assets.

Modified Cash Basis of Accounting refers to a blend of the cash basis of accounting and the accrual basis of accounting. It is a form of accounting based on actual receipts and disbursements and includes provisions for:

- a) Liabilities not paid when due;
- b) Unpaid dividends and interest refunds applicable to the accounting period;
- c) Deferred credits and charges applicable to future periods;
- d) Estimates of anticipated losses on loans outstanding and other risk assets; and
- e) Depreciation of fixed assets.

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CASH AND CASH EQUIVALENTS

Cash includes cash in banks (savings banks, S&L, etc.) and cash on hand ("vault" cash, cash in ATM machines, etc.). Cash equivalents include income-producing accounts (deposits) and certificates of deposits (with 3 months or less original maturity) in banks, savings banks, and S&Ls, etc. Because cash is the most liquid of assets, and is susceptible to being lost, stolen, and miscounted, federal credit unions should have an effective system of internal control for cash receipts, disbursements, recording, reconciliation, and review (audit).

CASH ON DEPOSIT

Cash on deposit includes balances on deposit in financial institutions and deposits in transit. These amounts may or may not be subject to withdrawal by check and may or may not bear interest.

Balances on Deposit

This classification represents balances on deposit at banks, credit unions, S&L's, corporates, etc. that the credit union may use to make daily deposits, replenish change funds, pay operating expenses, write loan checks, etc. These accounts should be reconciled on at least a monthly basis.

Deposits in Transit

Deposits in transit are part of the reconciliation. They represent deposits made at another financial institution that was immediately reflected on the credit union's books but for which credit was not yet received at the financial institution.

Monetary Control Reserve Deposits

This account is used to record monetary reserves held on deposit with the Federal Reserve System against its non-personal time deposits. The cash is held at the Federal Reserve in a non-interest bearing account.

Entries in the Journal and Cash Record

This account should be debited for any cash deposits made with the Federal Reserve System in the "Miscellaneous-Debit" column. It should be credited when the funds are withdrawn in the "Miscellaneous-Credit" column.

Illustrative Entries

- a) When a cash deposit is made into the Federal Reserve System:

Dr.-Monetary Control		
Reserve Deposits	\$5,450	
Cr.-Cash		\$5,450

- b) When the balance of the fund can be reduced and the funds are withdrawn:

Dr.-Cash	\$1,000.00	
Cr.-Monetary Control Reserve		
Deposit		\$1,000.00

CASH ON HAND

Change Fund

An FCU's board of directors may authorize the establishment of a Change Fund after it considers whether there is a need for it. This account is provided for those federal credit unions that maintain a cash fund for making change or for cashing checks. Other purposes for which a change fund may be used are to disburse share withdrawals or loans in cash or for redeeming U.S. Savings Bonds in cash. The board of directors must ensure that adequate safeguards and accountability exist to protect the fund.

This account is also used to reflect increases made to the change fund when to meet temporary demands for cash, such as on member's paydays. Funds involved in these temporary increases to the change fund should be re-deposited as soon as the need for them is served. In the event the actual cash (currency and coins) is depleted by members'

checks cashed from the fund, such checks should be deposited in the bank with the regular deposit and this account credited with the amount of the checks deposited. The fund should be replenished only by credit union checks which are drawn for the purpose and charged to this account.

Entries in Journal and Cash Record

Debit this account in the "Miscellaneous-Debit" column and credit Cash in the "Cash-Paid-out" column with the amount withdrawn from the bank by check to establish or to increase the fund. Credit this account in the "Miscellaneous-Credit" column and debit Cash in the "Cash-Received" column with the amount of the fund re-deposited.

Posting to General Ledger

Entries to this account are posted individually from the "Miscellaneous" columns of the Journal and Cash Record.

Verification of Fund

The amount of the fund should be verified by a count at the end of each business day. When the fund or portions thereof are handled by more than one person, precautionary measures to establish the responsibility of the individuals concerned should be taken.

"Fluctuating" Change Funds

The recordkeeping procedures in connection with Change Funds will prove suitable for credit unions with normal change fund activity. However, some credit unions may feel a need to adopt what is commonly referred to as "fluctuating" change funds. By "fluctuating" it is meant that the amount of cash in the fund will vary from time to time as a result of normal operations, and the fund will not be promptly replenished. In the interest of reducing the hazards in connection with cash handling, a "fluctuating" change fund can be authorized in order to:

a) Avoid the hazards of transporting currency to the bank.

b) Avoid the hazards of retaining more currency in the credit union office than is necessary for immediate needs.

The need for transporting currency to the bank is lessened by the practice of depositing checks instead of currency, whenever possible. In many cases, change fund currency is depleted through cashing members' checks, share drafts, or through making change for members' payments made by check. Frequently, this will result in the total of the checks and share drafts on hand at the end of the day being greater than the total of the vouchers representing payments to the credit union. If the credit union, in such a case, has no immediate need for replenishing the change fund, only the checks and share drafts need be deposited and the change fund can be reduced by the amount that the checks exceed the receipts for the day. Assuming that the receipts total \$800 and the checks total \$1,200, the entry should be:

Example 1:

Dr.-Cash	\$1,200.00	
Cr.-Shares		\$580.00
Cr.-Consumer Loans		200.00
Cr.-Interest on Loans		20.00
Cr.-Change Fund		400.00

In instances where the cash receipts for the day exceed the amount of the checks and share drafts, the entire amount of cash receipts must be deposited as provided in Section XIII of the Federal Credit Union Bylaws. However, if a change fund is in use, a credit union desiring to deposit only checks and share drafts (as a safety measure) may do so by increasing the change fund by the amount of the currency in the day's receipts. This can be accomplished by drawing a credit union check in the amount of the currency received during the day.

Assuming that receipts totaled \$900 of which \$800 is in the form of checks and share drafts, the entries would be:

Example 2:

(a) To record the credit union check drawn in the amount of the currency.

Dr.- Change Fund	\$100.00	
Cr.-Cash		\$100.00

(b) This check is deposited along with the checks received in the day's business to make up the debit to cash

Dr.- Cash	\$900.00	
Cr.-Shares		\$680.00
Cr.-Consumer Loans		200.00
Cr.-Interest on Loans		20.00

As previously discussed, credit unions may disburse share withdrawals or loans, or both, in cash. In the interest of reducing hazards, replenishment of the change fund may be delayed and if the officials so desire, the change fund can be reduced by the amount of the cash share and loan disbursements. Assuming that cash share and loan disbursements on any day amounted to \$500, the entry would be:

Example 3:

Dr.- Shares	\$200.00	
Dr.- Consumer Loans	300.00	
Cr.-Change Fund		\$500.00

To avoid a complex entry in the Journal and Cash Record, which could result from combining the above entry with other entries involving change funds, the above should be a separate entry. It should be supported by the cash disbursement vouchers which should be summarized on a Journal Voucher, or its equivalent.

By way of summary, fluctuation in the change fund that results from normal operations may occur as follows:

a) Change fund will be reduced:

- By excess of checks and members' share drafts over cash receipts (example 1).

- By cash share and loan disbursements (example 3).

b) Change fund will be increased:

- By replenishment checks drawn on the credit union's depository and cashed at the bank.
- By replenishment checks cashed from credit union receipts (example 2).

Regardless of the manner in which the change fund may fluctuate, change fund cash must be verified each day and cash over and short recorded, if applicable.

It is possible that some credit unions may have change funds of such a large amount that continual fluctuations occur without the need arising to replenish the fund with reasonable regularity, or to deposit excess currency. In such a situation, the change fund does not serve its intended purpose. Accordingly, the officials should relate the size of the change fund with the needs of the credit union and its surety bond coverage and, if necessary, reduce the amount of the change fund.

Illustrative Entries

a) When the change fund is set up or increased:

Dr.-Change Fund	\$50.00	
Cr.-Cash		\$50.00

b) When the change fund is decreased or eliminated:

Dr.-Cash	\$50.00	
Cr.-Change Fund		\$50.00

Detailed Transactions

Debit:

a) With amount of cash disbursed to establish the Change Fund.

b) With amount of cash disbursed to increase the Change Fund.

Credit:

- a) With amount of member's checks cashed from the Change Fund and deposited in the bank with the regular deposit.
- b) With amount of cash received representing a decrease or the elimination of the Change Fund.

Petty Cash

This account records the authorization of a Petty Cash Fund by the board of directors. The purpose of petty cash funds is for making incidental payments such as postage and other expense items of less than \$50. Payments from the petty cash fund must be evidenced by receipts or signed petty cash vouchers and are not posted to the Journal and Cash Record.

Setting up Petty Cash Fund

Debit this account in the "Miscellaneous-Debit" column of the Journal and Cash Record for the gross amount withdrawn by check from the bank to establish a petty cash fund. No subsequent debits or credits to the account are made except for the purpose of increasing or decreasing the amount of cash to be maintained in the fund. The amount set up in this fund should not exceed the maximum authorized by the board.

Posting to the General Ledger

Posting to this account in the General Ledger is made from the "Miscellaneous" columns of the Journal and Cash Record.

Payments for Petty Cash Fund

As payments are made out of the fund, receipts or signed petty cash vouchers should be obtained and held with the balance of the cash in the fund. Thus, the actual cash and/or receipts will always equal the total amount of the fund. No entries are made in the Journal and Cash Record for individual petty cash payments.

Replenishment

The petty cash fund is restored in full prior to the end of each dividend period, and at other times when necessary, in order that expenditures made may be recorded and that the cash in the fund will be equal to the balance in the General Ledger. When replenishment of the fund is necessary, a Journal Voucher is prepared and a check drawn in favor of "Petty Cash". Upon cashing the check, actual cash for the total of the fund should be on hand. The receipts, which were received when disbursements were made from the fund, equaling the amount of the check is attached to the Journal Voucher or filed with other paid bills.

Entry in Journal and Cash Record

When the petty cash fund is replenished, the transaction is entered in the Journal and Cash Record by debiting all of the applicable expense accounts and crediting the Cash account (Cash-Paid Out). Unless it is applicable, the total cost of the replenishment should not be debited to "Miscellaneous Operating Expenses". This entry does not affect the Petty Cash account as set up on the books.

Changes in Amount of Fund

If it is decided to reduce the amount of cash in the fund, a Cash Received Voucher is prepared. At the end of the day when the cash received transactions are recorded in the Journal and Cash Record, the amount should be entered in the "Miscellaneous-Credit" column as received from "Petty Cash". The amount taken from the fund is deposited with other cash received that day.

Segregation of Fund

The petty cash fund must be kept physically separate and apart from all other cash. The supervisory committee should verify the balance of the petty cash fund periodically by conducting surprise cash counts.

Illustrative Entries

- a) To establish the petty cash fund:

Dr.-Petty Cash Fund	\$25.00	
Cr.-Cash		\$25.00

- b) To replenish the fund:

Dr.-Various Operating Ex- pense Accounts	\$16.79	
Cr.-Cash		\$16.79

- c) To reduce or eliminate the petty cash fund:

Dr.-Cash	\$20.00	
Cr.-Petty Cash Fund		\$20.00

Detailed TransactionsDebit:

- a) With amount of cash disbursed to establish the Petty Cash Fund.
- b) With amount of cash disbursed to increase the Petty Cash Fund.

Credit:

- a) With amount of cash received (or vouchers recorded) representing a decrease in the Petty Cash Fund or creation of the Fund.

GENERAL CASH HANDLING AND ACCOUNTING PROCEDURES**Accounting for Cash Receipts**

Whenever cash is received, a Cash Received Voucher or equivalent should be prepared. It is recommended that the voucher be filled in by the members for all members' payments to the credit union. The person receiving the cash should enter the amount of the payment and the purpose in the member's Passbook or equivalent. The Cash Received Voucher serves as a posting medium from

which entries are made in the Individual Share and Loan Ledgers. (Note: On-line, data processing systems have replaced the need for passbooks and can provide the member with current share and loan balances.)

At the end of each business day the totals of the Cash Received Vouchers for that day should be added. The total of the vouchers should be the same as the total cash received and on hand for that day. If it is not, the "Cash Over and Short" should be charged or credited. After the totals of the vouchers are reconciled with the cash on hand and the summary voucher prepared, the amounts appearing on the summary voucher should be entered in the Journal and Cash Record and the amounts on the individual vouchers should be posted to the Individual Share and Loan Ledgers. The use of total payment vouchers and the handling of mail receipts are discussed under another section.

The summary voucher should be attached to the individual vouchers. The totals of the individual amounts paid in on Shares, Share Certificates, Loans, Interest on Loans, Fees and Charges, etc., may be determined by the use of an adding machine. The adding machine tape should be attached to the summary voucher.

Cash received by the credit union must be deposited in the bank promptly as required by Article XIII of the Bylaws. Deposits in the bank will ordinarily consist of an entire day's receipts as entered in the Journal and Cash Record. If the amounts are small, more than one day's total receipts may be combined in a single deposit provided that no funds are held for more than the time limits specified in the Bylaws. Credit unions, however, occasionally find it expedient to deposit funds in the bank during the course of a business day and to include in the deposit all receipts up to the time the deposit is prepared in order that comparatively large amounts of cash will not be on hand in the credit union. Usually, such credit unions will prepare two deposits for each day's business, but only one entry in the Journal and Cash Record need be made. The total of the two deposits should agree with the cash receipts for the day as shown by the entry.

Credit unions making more than one bank deposit during a business day may "cut off" the day's business at a certain specified time, usually at the time of the bank deposit. All transactions subsequent to the cut off time are considered as the business of the following day and are so dated. The establishment of a policy by the board of directors for cutting off the day's business should be made known to the members. In order that cash can be easily traced, the bank deposits should be identifiable with the cash receipts as entered in the Journal and Cash Record. So that the credit union will have a record of the persons who made payments in case the cash receipts are lost or stolen before they have been deposited in the bank, the Cash Received Vouchers should immediately be segregated from the cash. Checks should be promptly endorsed "for deposit only" when they are received to reduce the possibility of their being negotiated if they are stolen. For internal control purposes, the deposit slips should be prepared in duplicate for all bank deposits and the duplicate be retained in the credit union files. Showing bank transit numbers for checks included in the deposit is suggested.

The cash of the credit union must be kept separate and apart from all other cash. Under no circumstances should the personal or other cash of the officers and employees be commingled with the credit union's cash.

Accounting for Disbursements

Disbursements should be made by check, except those authorized from petty cash and wire transfers. The canceled checks serve as receipts for money paid out by the credit union. Although no standard form of check is prescribed, there are certain advantages to the use of checks which have the check number, the credit union's name and spaces for signature and countersignature preprinted. Regardless of the form of check used, all checks should be pre-numbered.

Spoiled checks should be marked "Void" and filed for audit purposes in their regular numerical order with their applicable bank statements and canceled checks.

Unless the board of directors has authorized otherwise, all checks should be signed and countersigned. The countersigning provides an additional element of control over the disbursements. The financial officer, assistant financial officers, manager and assistant managers may be authorized to sign checks. The executive officer and the assistant executive officer(s) should be authorized to countersign. The board of directors may resolve that checks can be issued with the signature of only the financial officer, assistant financial officer, manager or assistant manager. Before acting on such a resolution, the board must be sure that adequate internal controls are in effect and that countersignatures are no longer required to insure the satisfactory operation of the credit union.

Each bank usually has its own resolution form which corporations fill out in connection with the authorization of certain officers to sign and/or countersign checks. For this reason, no standard resolution form is prescribed.

If the checks used by the credit union do not provide for a duplicate copy and voucher format, a Journal Voucher or its equivalent, should be prepared for each disbursement. Amounts disbursed are posted to the "Cash-Paid Out" column of the Journal and Cash Record.

For each disbursement, a Journal Voucher or its equivalent should be prepared. This form should be used as a source for all entries in the Journal and Cash Record other than cash receipts. It can also be used for non-cash transactions, such as transfers from shares to loans. However, when the form is used for this purpose, it should describe the reason for the entry on the face or reverse side of the form.

The Journal Voucher serves as a convenient medium for posting items to the Individual Share and Loan Ledgers. Spaces should be provided on the form to show who approved or authorized the disbursement and the signature of the person receiving the check. Since the member's signature should appear on the canceled check, members do not need to sign the Journal Voucher.

The use of a Journal Voucher Form is optional; its use, however, is strongly recommended to stan-

standardize and simplify the means for showing authorization of disbursements, transfers and Journal entries and to keep the types of posting media to a minimum. A substitute form can be developed such as a source document for posting using electronic data processing (generally requires carbon copies). However, in order to serve the same needs served by the Journal Voucher, most of the information appearing on the Journal Voucher will need to appear on the substitute form. For electronic data processing (EDP) posting, transaction processing codes should be included.

Each check should be posted individually in the Journal and Cash Record in numerical order from the information provided on the Journal Voucher form. Entries should also be made in the member's Individual Share and Loan Ledger for all transactions with the member, such as share withdrawals and loans made.

Non-cash transactions may be summarized on a Journal Voucher form or its equivalent. This summary voucher should show the total of the day's non-cash transactions and should be attached to the individual vouchers. In such a case, the summary voucher will be the basis for the daily summary entry in the Journal and Cash Record for non-cash transactions.

The credit union may issue duplicate checks to payees who have lost their original checks. In such cases, a stop payment order to the bank should be issued against the original check. Before a new check is issued, it should be determined from the bank that the original check has not been paid. In doing so, credit unions may require an indemnity bond from the payee if circumstances warrant such action. The issuance of a duplicate check should be recorded in the Journal and Cash Record in "Date", "Account No.", "Name of Item", and "Check No." columns with the purpose for its issuance noted in the "Name of Item" column. It is suggested that a cross-reference be made on the line on which the original check was entered.

If a duplicate check is issued in place of an original check still carried as outstanding in the cash amount, no entry of the amount should be recorded in the "Cash-Paid Out" column. If a duplicate

check is issued in place of an original check which was transferred to Accounts Payable or Other Income, the new check number and the number of the check being replaced must be recorded. The amount of the duplicate check should be credited in the "Cash-Paid Out" column and debited to "Accounts Payable", or "Other Income", as required, in the "Miscellaneous-Debit" column.

Member's Check and Drafts Returned

When the bank returns a member's check or draft because of insufficient funds or any other reason, an entry should be made debiting "Other Accounts Receivable", and crediting "Cash", for the amount of the check plus any charges made for returning the check or draft. This entry sets up the check temporarily as an asset or receivable due from the member pending a determination of its collectibility. The member should be contacted immediately and the amount due collected from him/her. Upon payment by the member of the amount due, a reversing entry should be made debiting the "Cash" account and crediting the "Other Accounts Receivable" account.

It is suggested that the amount collected be deposited separately in order that all checks or drafts returned and their subsequent redeposit can be easily traced through the credit union's records. A memorandum notation of the checks or drafts returned should be made on the member's Individual Share and Loan Ledger. The subsequent disposal of the check or draft, either by the member making it good or by charging it back against his/her account, should also be noted on the member's individual ledger.

The board of directors should determine whether the service charges in connection with returned checks or drafts are to be charged to the members concerned or are to be considered a credit union expense item. The amount of the service charge should, therefore, be either a debit to "Other Accounts Receivable" (or to the member's share account if the check or draft is not made good) or to "Bank Service Charges", depending upon the policy of the board. A fee may be assessed to members to recover costs involved in processing checks or drafts returned but the fee may not be in the na-

ture of a penalty. The fee may reflect, but not exceed, the direct and indirect costs involved in processing checks or drafts returned for insufficient funds. If the member does not make good on the returned check within 1 week following its return by the bank, the credits originally made should be reversed. Assuming the original check covered both shares and a payment on loan and interest, the entry in the Journal and Cash Record to reverse the original credits would be:

Dr.-Shares	\$5.00
Dr.-Loans	24.00
Dr.-Interest on loans	1.00
Cr.-Other Accounts Receivable	\$30.00

Dr.-Cash	\$10.00
Cr.-Other Fees and Charges	\$2.00
Cr.-Shares	\$8.00

Posting to General Ledger

When the transactions which have been entered in the Journal and Cash Record are posted to the General Ledger accounts, the Cash account is debited with the total of the "Cash-Received" column and credited with the total of the "Cash-Paid Out" column. These totals are usually posted at the end of each month.

Depositing Cash

All cash received should be deposited in the bank account within the time provided by Article XIII of the *Federal Credit Union Bylaws* (usually daily). Deposits should ordinarily be made in amounts which exactly equal one or more day's cash collections, as shown on the daily summary vouchers and in the Journal and Cash Record.

Illustrative Entries

Receipt of Cash:

a) When entrance fees (*Federal Credit Union Bylaws*, Article II, Section 2, if authorized by the Board) and payments on shares are received from members:

Dr.-Cash	\$10.00
Cr.-Other Fees and Charges	\$2.00
Cr.-Shares	8.00

b) When an installment on a loan is paid and interest and late charges are collected:

Dr.-Cash	\$11.20
Cr.-Loans	\$10.00
Cr.-Interest on Loans	1.00
Cr.-Fees and Charges	.20

c) When payment is received for: loan interest of \$15.50, legal and collection expenses of \$10 deducted by an attorney or collection agency from the payment made by the borrower, and the remaining funds of \$72.50 applied to the borrower's loan balance (loan has not been charged off):

Dr.-Cash	\$78.00
Dr.-Collection Expense	10.00
Cr.-Interest on Loans	\$15.50
Cr.-Loans	72.50

d) When a refund, recovery, or adjustment of an expense is received:

Dr.-Cash	\$2.00
Cr.-Appropriate Operating Expense Account	\$2.00

e) When interest or dividends are collected on investments:

Dr.-Cash	\$12.50
Cr.- Income from Investments	\$12.50

Disbursement of Cash by Check or Bank Charges***Illustrative Entries***

- a) When a member withdraws cash from his/her share account:

Dr.-Shares	\$20	
Cr.- Cash		\$20

- b) When a loan is made to a member:

Dr.- Loans	\$10	
Cr.- Cash		\$10

- c) When a member having a note outstanding with an unpaid balance of \$10.00, gets a new note for \$50.00, and receives a \$40.00 check and his old note:

Dr.- Loans	\$50	
Cr.- Cash		\$40
Cr.- Loans		10

Note: If the Journal Voucher is used, the new loan should be entered as a debit for the gross amount, the balance of the old loan as a credit item, and the voucher should show the net cash paid opposite "Amount" on the check.

- d) When an expense is incurred and paid upon receipt of bill:

Dr.- Appropriate Expense Account	\$15	
Cr.- Cash		\$15

- e) When a check is drawn on the bank to establish a petty cash fund:

Dr.- Petty Cash	\$10	
Cr.- Cash		\$10

- f) When a loan is made to another credit union on its note, interest to be paid at maturity and check issued:

Dr.- Loans to Other Credit Unions	\$1,000	
Cr.- Cash		\$1,000

- g) When the change fund is set up or increased:

Dr.- Change Fund	\$50	
Cr.- Cash		\$50

- h) When a service charge is made by the bank:

Dr.- Bank Service Charges	\$1.75	
Cr.- Cash		\$1.75

Detailed TransactionsDebit:

- a) With cash receipts.
- b) Bank reconciliation "addition" adjustments to the credit union's book balance.
- c) Checks or drafts for insufficient funds when they are re-deposited.

Credit:

- a) With cash disbursements made by check.
- b) With bank services charges assessed by the bank, and other book balance "deduction" adjustments on the bank reconciliation.
- c) Checks or drafts returned for insufficient funds.

Balancing out Teller's Funds

With credit union growth and expanded activities, the cash procedures needed to properly serve the members sometimes become more complex. In this section and the next section on "Special Procedures for Disbursements" some of the procedures and forms pertinent to the multi-service credit unions are discussed.

At the close of business each day, each teller should balance the receipts and disbursements for the day to the cash count. This should be accom-

plished by completing a "Teller's Daily Cash Sheet" or equivalent. In balancing the receipts/disbursements to the cash count the following steps should be followed:

a) Cash Count

1) Count all cash (bills and coins) in the cash drawer and enter the amounts on the form and total.

2) List and count the checks and share drafts received. At the time they are received, share drafts should be stamped "paid" or "canceled" to prevent their being removed from the daily work and presented for payment again. If only a few have been received, they can be entered separately in the cash count section. If a large number are received, an adding machine tape can be prepared or a separate listing can be attached to the form. No matter what method is used, the teller should identify each item. If a separate listing of the checks/share drafts is prepared only the total amount of the items need be shown in the cash count section.

3) Add the cash on hand and checks and share drafts received to arrive at the total for the cash count.

b) Change Fund

1) Determine the closing change fund amount. This can be determined by taking the opening change fund and adjusting it for increases in funds received or decreases in funds for the day. For each increase or decrease to the change fund, the teller should have a signed receipt showing the transfer of the funds to or from another teller or the Head Teller.

2) Enter the opening change fund and any increases to the change fund in the receipts column. These figures should be shown separately.

3) Enter all decreases to the change fund in the disbursements column.

c) Receipts

1) Prepare a Summary Cash Received Voucher. This is accomplished by adding each total on the individual cash received vouchers. The total of these items should then be entered on the Daily Cash Sheet under the appropriate heading.

2) Add separately the amounts for payments on shares, entrance fees, late charges, interest on loans and loans. Total. This total should also appear on the Summary Cash Received Voucher.

3) In the space provided on the form, identify and include any miscellaneous receipts.

4) Total the receipts from members and miscellaneous receipts to arrive at the total cash receipts.

d) Disbursements

1) Prepare Summary Journal Voucher for the items disbursed in cash. This would include cash share withdrawals (including cash withdrawals from a share draft account), loans or advances on lines-of-credit and savings bond redemptions. The total of each item and the grand total should then be entered on the Daily Cash Sheet under the appropriate headings.

2) In the space provided on the form ("Other Disbursements in Cash") identify and include any miscellaneous cash disbursements.

3) Total the items described in (1) and (2) above to arrive at total cash disbursements for the day.

e) Balancing

1) Add total cash receipts, opening change fund and any increases to the change fund to arrive at total cash.

2) Add total disbursements in cash and any decreases to the change fund to arrive at total disbursements.

3) Subtract the total of disbursements and change fund decreases from the total cash receipts to arrive at the closing change fund balance. This figure should agree with the total of the cash count. If the figures do not agree, all

figures should be rechecked for errors. If the difference cannot be located after extensive checking, and it is not material, the difference may be entered as "Cash Over or (Short)" on the "Teller's Daily Cash Sheet".

4) Depending on the nature of the cash difference, add or subtract the amount from net cash proceeds to arrive at an adjusted balance. The adjusted balance should agree with the total of the cash count.

5) Reconcile the teller's change fund. If the teller is assigned a specific amount to be maintained in the change fund and the disbursements for the day exceed receipts, the change fund will need to be replenished. The change fund does not have to be replenished if the credit union uses a fluctuating change fund.

Reconciling the Cash on Hand

After the individual tellers have balanced out their daily business, the cashier (Head Teller) should consolidate all teller activity on the Cashier's Daily Summary. This procedure is necessary so that the bank deposit can be prepared and the cashier can determine if the change fund will be adequate to begin operation the next day. The consolidated totals for each item are also needed for posting the daily activity to the Journal and Cash Record.

The use of these forms, or their equivalent, will assist management by providing summarization and records for reconciling and controlling funds on hand.

Check Endorsements

There are three kinds of endorsements that are generally presented to a credit union on a check or draft. These three endorsements are:

a) Blank Endorsement - This consists of the endorser's name written on the instrument or the paper firmly affixed thereto for that purpose. If an instrument has been drawn payable to "cash" and is endorsed in blank, it becomes payable to bearer and may be negotiated by delivery, without endorsement. For example, if a check is made payable to "John Doe or Cash" and signed by John Doe, as

bearer, it would not have to be signed on the reverse side by him because it becomes a blank endorsement. Nevertheless, it is a sound policy to require the member to sign these checks.

b) Special Endorsement - This endorsement specifies the person to whom or to whose order it makes the instrument payable. Any check specifically endorsed becomes payable only to the person whose name appears on the instrument and can only be paid when that person's endorsement is affixed to the back of the instrument. If John Doe writes a check, "Payable To The Order Of Bill Smith", the check cannot be honored until Bill Smith endorses the check on the back.

c) Restrictive Endorsement - A person who endorses an instrument may impose certain restrictions upon his endorsement. An endorsement is restrictive which either:

- 1) Is conditional;
- 2) Purports to prohibit further transfer of the instrument;
- 3) Includes the words "for collection", "for deposit", "Pay any bank", or the terms signifying a purpose of deposit or collection; or
- 4) Otherwise states that it is for the benefit or use of the endorser or other persons.

Total Payment Vouchers

A Total Payment Voucher may be used as a means of speeding up window activity. This is particularly useful where level-payment methods are used for collecting loan and interest payments and where members' individual accounts are not posted at the window. Where this method is used, the total payments must be distributed to shares, loan principal and interest, etc., for entry into the Journal and Cash Record and for posting into the individual accounts. The information needed for the distribution may be obtained from the individual accounts in the course of posting them. When posting or electronic data processing furnishes the distribution totals, they may be used for entry in the Journal and Cash Record. However, when the individual accounts are hand posted or when the accounting ma-

chine is not capable of furnishing the necessary totals, the distribution ordinarily will be shown on the individual vouchers. The vouchers should then be totaled to furnish the entries for the Journal and Cash Record.

In the event that the breakdown of Shares, Loans, Interest, etc., is not developed in time to provide the credit entries for the total payments, the amount of the total payments should be credited to "Accounts Payable, Undistributed Payments". When the breakdown of the total payments has been determined, the amount in Account Payable, Undistributed Payments should be cleared by debiting that account and crediting Shares, Loans, Interest, etc.

Since the benefits of the total payment plan will be derived only if used in conjunction with a total payment receipt or a total payment passbook, a statement of account must be furnished to the members.

On either the front or back cover of the total payment passbook, there should be printed, an explanation of the total payment procedure including an indication to the member that he will receive a statement of account showing all his share and loan balances and a detailed breakdown of the credits to his accounts.

Mail Receipts

When Passbooks are Used

Postings to the passbook represent the member's official record of transactions. Therefore, the credit union should require the members to submit the passbooks with mail payments so that the proper postings can be made upon receipt and the passbooks can be promptly returned to the members. If any mail payments are received without the passbooks, the credit union should mail back temporary receipts accompanied by instructions to mail or bring in the passbooks so that they can be brought up to date.

For members who mail in their payments, the credit union may arrange to return their passbooks to them in a special envelope, enclosed in which there would also be a Cash Received Voucher for the

next payment. If the envelope has a window opening and the member's name and current address is so positioned on the passbook, the need for addressing the envelope to the member will be eliminated.

Enclosing a return envelope, pre-addressed to the credit union, with the passbook will also facilitate payment. A variation of the plan discussed above would be to use an ordinary window envelope to return the passbook to the member, enclosing a pre-addressed return envelope on the flap of which the Cash Received Voucher is printed.

When Statements of Account Are Used

Under all circumstances, members should receive a receipt for his/her payment. However, when a statement of account plan is used, the member's official permanent record for transactions shall be the statement of account. The member will thus be able to compare the payments shown on his/her periodic statement of account with his/her canceled checks, money order stubs, or other evidence of his payments that he/she retained after the payments were made. The board of directors could decide to eliminate receipts when mail payments are made by check or money order. For the proper protection of the members and the credit union, receipts should be mailed to any member who sends cash (coin or currency) through the mail even when a statement of account plan is used. Because of the hazards involved, the credit union should discourage sending cash through the mail.

Due to the nature of mail receipts, credit union management must ensure that proper internal controls are established for the handling of mail receipts, i.e., opening mail receipts under dual control, posting receipts separately by teller number, etc.

Coupon Book Plans for Loan Repayments

A coupon book method for loan and interest repayments has the advantage of eliminating the need for preparation of Cash Received Vouchers and the calculation of interest at the window when loan payments are made on schedule. Furthermore, since coupon books are feasible only when the interest and loan are set up on a level-payment plan, the exact amount due from the member at each payment date is known. Coupon books are advantageous to those credit unions where a large proportion of the membership pays its loans by mail.

The amount of the payments and the member's account number may be perforated through all the coupons in a book by means of a perforating machine. The coupons are pre-numbered consecutively as to payment number, beginning with No. 1 for the first payment. Coupon books may be prepared with any number of coupons to be used with loans of varying maturities.

In addition to showing the amount of the payment and identification of the member, the coupon must show the due date. It should also provide space for the member to show the distribution of any payments made in addition to those shown on the pre-recorded portion of the coupon - such as payments to shares. The coupon can be so designed that it will serve as an effective Cash Received Voucher, thereby eliminating the need for the credit union to prepare a voucher when each coupon is received. The date on the voucher portion of each coupon or on the separate Cash Received Voucher should be the date of receipt of the funds by the credit union.

The front or back cover of the coupon book may be used for instructions to the member in making payments or such instructions may be printed on the face of each coupon.

In using a coupon book plan the board of directors may adopt a grace period following the due date of each payment in order to ease the task of computing interest.

Balancing Teller's Cash Receipts and Disbursements using Online Computer Terminals

The following procedures or their equivalent should be used by each teller in balancing his/her assigned funds:

- a) Obtain computer terminal Teller Totals for the day's transactions.
- b) Keep all miscellaneous receipts, both vouchers and money, separate from share and loan receipts.
- c) Prepare adding machine tape of all checks, share drafts and money orders, etc., in the cash drawer that were received.
- d) Count the cash.
- e) Compare total of checks and cash to the ending balance of the Teller Totals.
- f) Prepare adding machine tape of all check disbursement vouchers.
- g) Compare the tape total to the total amount of checks issued.
- h) Determine that any cash over or short amounts are recorded. Adjust the ending cash balance, if applicable.
- i) After balancing has been accomplished, the head teller should clear the teller terminal totals.

When the above procedures are followed, the teller's cash on hand should balance to the appropriate computer totals. The cashier, after receiving all funds from the tellers, should prepare the Cashier's Daily Summary (or its equivalent). Modifications in this form may be required, as determined by the particular computer system being used.

Receipts and Disbursements using Automatic Transfer Accounts and NOW Accounts

With the passage of the Depository Institution De-regulation and Monetary Control Act of 1980, banks and savings and loans were given the authority to offer Automatic Transfer Accounts and Negotiable Order of Withdrawal Accounts (NOW),

respectively. Federal credit unions may use these accounts for disbursing credit union funds as long as the account is with an institution which meets the criteria of Section 107(7) or (8) of the Federal Credit Union Act. Since this account is similar to a checking account, it can be used in place of a regular checking account by the credit union. Before a decision is made to use one of these accounts, the board of directors must assure themselves that it will be in the credit union's best interest. The board should review the cost involved and the effects it will have on the credit union operation. These accounts have some of the same features as a share draft account in that the account earns interest/dividends and that the checks/drafts are usually truncated (meaning the canceled checks/drafts might not be returned to the credit union).

If the checks/drafts are truncated, the credit union must be sure that it will be able to obtain a copy of the canceled check or draft. Furthermore, although these accounts will earn interest/dividends, many of the programs developed have service charges which are not associated with a regular checking account. Requirements imposed on these accounts differ widely among financial institutions; therefore, the board should study several programs before making a final decision.

Procedures for Cash Disbursements/Check Register

A savings of time and effort may be realized by the use of a check register. A check register is a record used to record individual checks drawn. The information from the check register is totaled each day and entered in summary entry form in the Journal and Cash Record. Beginning and ending check numbers and note numbers should be shown in the appropriate columns.

A check register should provide the following minimum information to insure proper internal controls:

- Date of payment;
- Name of the payee;
- Account number of the member, when applicable;
- Check number in numerical sequence;

- Note number, if applicable;
- Amount of the disbursement;
- Purpose of the disbursement; and
- Amounts extended to the respective General Ledger Account(s).

Journal Vouchers designed or adapted to provide the above minimum items of information can be used as a check register. Two other types of commonly used check registers are discussed below.

Listed Check Register

A check register may show a listing of each individual check on a form designed to fit the credit union's needs, but care should be exercised to include at least the minimum information listed above. The purpose of the disbursement can be shown in columnar form with the columnar headings designating the purpose, such as a column headed "Shares" in which the amounts of share withdrawals are shown on the horizontal line with the appropriate check number and other information.

When accounting machines are being used, the machine by-product (proof sheet, journal sheet, etc.) may be used as a check register. The information that is typed on the check is reproduced on the machine by-product. Other minimum information is typed directly on the machine by-product.

As a means of eliminating the use of Journal Vouchers, or its equivalent disbursement vouchers, with a listed check register, additional columns can be provided for showing information that appears on the voucher form, such as approval or authorization for the disbursement, and acknowledgment of receipt of the check by the member, if applicable, and the related journal entry.

Voucher Check Register

In a voucher check arrangement, the check and one or two copies are prepared simultaneously. These copies can serve as a journal voucher and/or as a check register. Under the voucher check arrangement, the check is given to the payee, and the copy(ies) are retained by the credit union.

Either a duplicate or triplicate voucher arrangement is acceptable. Under a triplicate system, the first copies are sorted into account number order for posting to the member's accounts. A Journal Voucher (or its equivalent) should be attached to these copies, summarizing the transactions for the entry of the day's disbursements in the Journal and Cash Record, thus eliminating the necessity of entering each check individually. The last copies of the checks are sorted in check number order and become the check register. If a duplicate voucher check arrangement is used, only one copy of the check is prepared. These copies are first sorted in account number order for posting to the members' accounts. After the posting is accomplished, the copies should be sorted in check number order to become a check register. The summary voucher for that day's disbursements should be attached to the copy of the first or last check number written for the day.

The copies of the voucher checks must provide space for all of the information needed for journal vouchers. Space will also be provided for the note number. The check register copies will need to provide the minimum information needed for check registers as outlined above.

Voucher checks will usually be obtained in loose form; therefore, extra care must be exercised in storing these because the loss of these checks may not be noticed as readily as when bound books are used. All unused voucher check stock must be placed under the control of one employee. This employee will be responsible for determining that all usage is accounted for, by check numbers on a daily basis.

Voucher check forms will be designed to meet the needs of the credit union. To maintain the confidential relationship required by the Federal Credit Union Bylaws, the purpose of the disbursement must not appear either on the face or reverse side of the check.

Disbursing Share Withdrawals and Loans in Cash

Generally, federal credit unions find that they can operate efficiently making disbursements for share withdrawals and loans by check. However, when

the volume of checks issued for these purposes becomes burdensome, the board of directors may want to authorize the payment of either share withdrawals or loans, or both, in cash. In its authorization, the board should set a limit on the amount of cash that may be disbursed with each transaction.

Making payments in cash will undoubtedly increase the credit union's change fund needs. When authorizing disbursements in cash, the directors should also consider whether the size of the change fund needs to be increased and whether surety bond coverage is adequate (refer to Section 713.5 of the *National Credit Union Administration Rules and Regulations*) and authorize any necessary adjustments.

Disbursements in cash should be made to members and joint owners only in person, and only for the purposes and within the conditions stipulated by the board. Forms used for disbursing cash to members may not serve as authorization for payments to third parties. Disbursements in cash may be made for share and loan transactions only and may not be extended to other types of disbursements, except for disbursements out of Petty Cash. If the credit union is an authorized agent for the redemption of U. S. Savings Bonds, the board may authorize redemption of the bonds in cash in accordance with the procedures outlined in this manual.

The Journal Voucher forms used for disbursements by check are usually not suitable for disbursements in cash. The significant features of a form to be used for disbursements in cash are: (1) the form must provide information about the transaction so that it may be used as a source document to support the entry in the Journal and Cash Record and the posting to the member's ledger, (2) the form must provide space so that it may serve as a receipt, or acknowledgment, from the member signifying that he has received the cash, and (3) the form must provide space for the signature or identification of the person making the disbursement. If a credit union disburses both shares and loans in cash, it may design a combined form for this purpose.

It is preferable for control purposes that separate forms be used for disbursements in cash and disbursements by check. However, if it is desired that

one form be used to accomplish both purposes, the form must provide space for clear identification of whether the disbursement was made by cash or by check, the check number, the signatures of the person who paid the cash, and the person who received the cash, as well as the other information about the transaction so that the voucher can serve as a source document.

Effective control must be established for disbursements in cash. For example, when shares have been pledged as security for a loan, procedures must be established to prevent the disbursement of the pledged shares. Before cash is disbursed as loan proceeds, the disbursing official or employee must make certain that all of the required loan papers are properly completed including: an approved loan application; a note signed by the borrower and all the required co-makers; and all completed and secured collateral and security documents.

The following are accounting procedures for disbursing share withdrawals and loans in cash. The cash disbursement forms should be totaled daily and a summary prepared on a Journal Voucher, or its equivalent. From this summary voucher a summary entry should be made daily in the Journal and Cash Record to reflect the debits to Shares and Loans. The corresponding credit will be to Cash and should represent the check drawn to replenish the change fund for the disbursements in cash for the day. The number of the check issued to replenish the change fund must be entered on the summary Journal Voucher. If summary entries for disbursements by check are made in the Journal and Cash Record, the check issued to replenish the change fund will be included in the summary entry.

If the checks are entered individually in the Journal and Cash Record, the entry therein for the disbursements in cash will reflect the issuance of the check for the change fund replenishment.

Postings to the member's ledgers should be made from the cash disbursement forms. These forms and the summary Journal Voucher should be retained in the same manner as other source documents.

Check Signing Machines

If a large volume of checks are issued, the use of a check-signing machine may be warranted. Desirable safeguards in using a check-signing machine are that:

- a) The plate bearing the signer's facsimile signature needs to be used under his/her exclusive control at all times.
- b) The signer whose plate is being used in the machine should be present at the time his/her signature is being impressed on checks.

Circumstances may be such that a credit union may not be able to arrange for use of a check-signing machine with the signature plate of an authorized employee or official who will always be in a position to control his/her signature plate or be present when his plate is being used. Under such circumstances, the following safeguards should be established:

- c) The board of directors and the official or employee whose signature plate is being used in his/her absence should authorize certain other persons to use such plate.
- d) The board of directors should determine that the individual whose signature plate is being used in his absence recognizes and takes full responsibility for all checks issued with his/her signature on them.
- e) The board of directors should ensure that the following controls are established and maintained to protect against improper use of the machine:

- 1) The check-signing machine should have a counter to record or count each check inserted for signature, and this counter device should be under lock with the key in the possession of someone other than those who operate the machine.
- 2) A register or control record should be maintained which will show the check number, the date and initials or signature of the person who operated the machine. If numerous checks are signed at one time, and since

checks are issued in straight numerical sequence, only the number of the first and last checks so processed need be listed in the register, or control record, along with the date and initials or signature.

3) The number shown on the counter device on the machine should be entered at the end of each day in the register or control record. The number of checks issued for the day as shown by the counter device will thus correspond with the number of checks listed in the register or control record. Any discrepancies in such numbers must be accounted for or explained in the register or control record.

Check Protectors

Machines which will indelibly imprint the amount of the check, commonly known as "check protectors," are also available. In some versions, these machines are equipped with registers which accumulate the number and amount of checks processed through the machine. It is possible to obtain a combination check signing and protecting machine in a single unit.

Check Writing Machines

Various computing equipment which will write the complete check are available. These machines are usually programmed to operate independently or to produce a computer-generated output. They will perform certain or all functions in writing a check with minimal input from a teller or other employee. At least the following controls must be established and maintained in order to protect against improper machine usage:

a) The check-writing machine should have a counter to record or count each check written. This counter device shall be under lock with the key in the possession of someone other than those who operate the machine.

b) A register or control record should be maintained (some machines prepare this at the time the check is written) which will show the date and initials or other identifying symbol of the person who used the machine.

c) Daily balancing of the number of checks written to the number of blank checks used should be performed.

d) The surety company should be notified of the proposed machine usage in order that surety can indicate whether full bond coverage will continue in force.

e) If the check-writing machine also signs checks, the control procedures for the signature plate, as discussed under check-signing machines, should be followed.

Loan Drafts

A draft, sometimes referred to as a bill of exchange, may be defined as follows:

A draft is a formal written order directing the payment of money by a specified party to another party, who may or may not be the maker or drawer of the instrument.

Relating the above definition to a draft transaction as it might be handled by a credit union, the maker or drawer of the draft instrument would be the credit union itself. The draft will ordinarily be made out to either the member or to a vendor such as an automobile dealer from whom the member desires to purchase some goods to be paid for by the proceeds of the draft. The "specified party" is the credit union's bank since the draft is actually drawn upon it.

There are many different types of drafts, or bills of exchange, all of which serve a definite purpose under certain conditions or circumstances. A common type is a check. An important feature of the type of draft generally used by credit unions, which is also true of most types of drafts or bills of exchange, is that the instrument must be honored or accepted by the party upon whom it is drawn.

There may be diversification of the use of draft procedures by federal credit unions. There are many complexities involved in the effective use of drafts. Generally these complexities develop because of local laws and customs. As a result, a credit union must be certain that it is equipped to

legally and effectively carry out the responsibilities connected with the use of drafts.

Some credit unions may find that the use of drafts facilitates loan transactions with its members, especially with members located at a point distant from the credit union. Drafts can be used by credit unions in connection with any loan transaction, but they are perhaps most commonly used with automobile loans.

Liability in Connection with Loan Drafts

An important question arises as to whether the credit union incurs a liability at the time authorization is issued for a draft to be drawn upon it, or whether no liability exists until the draft is accepted. A number of factors influence the answer to this question since these factors are of a legal nature, based upon the nature of the draft documents and procedures, and since these factors will vary in different jurisdictions, the credit union must be guided by the advice of its attorney in determining whether it incurs a liability upon authorization of a draft.

If it is determined that the credit union incurs a liability when a draft is authorized, "Accounts Payable-Drafts Authorized", should be credited for the amount authorized. This account should be debited when the draft is paid by check, or when the authorization is voided.

Drafts issued by the credit union which have not been presented for payment after a reasonable period has elapsed (90 days or more) should be transferred to "Accounts Payable." The following entry should be used to transfer those old drafts:

Dr.-Accounts Payable - Drafts
Authorized
Cr.-Accounts Payable

If the credit union determines that it has no actual liability until the draft is accepted, it may then have a contingent liability upon authorization of a draft to be drawn. In either case, the authorized draft must be disclosed on the credit union's financial statements in order to permit valid analysis of the credit union's financial condition. Accordingly, the

disclosure should be shown on the Statement of Financial Condition as a note, to read as follows:

As of (Date), the credit union has authorized drafts to be drawn upon it in the amount of \$_____ which have not been presented for acceptance.

Records in Connection with Loan Draft Procedures

Management of the credit union has a definite responsibility to prepare and maintain complete and accurate records of draft transactions. Draft authorization copies and other papers relating to the transaction should be filed in a separate folder for each transaction until the draft is accepted and paid. This will provide a greater measure of control over the outstanding items than if the papers were filed in the normal fashion.

Further control over outstanding draft authorizations will be provided by a draft register or daily record of draft transactions. The draft register should be in columnar form and provide information necessary for control over the operation, depending on the nature of the credit union's procedure. Suggested columnar headings are listed below:

a) Date authorized. (This should also be the date of entry in the draft register.)

b) Draft number or authorization number. If the credit union furnishes the draft instruments to the potential drawers of the drafts, the draft instruments should be numbered consecutively in the same manner as checks are numbered. The draft authorizations should be similarly numbered. The best control would be achieved if the draft form and the draft authorization for the same transaction bore the same number.

c) Name. The drawer's name should be shown. If the drawer is an individual, such as an automobile vendor, other than the member involved in the transaction, both his name and the member's name should be shown in this column.

- d) Account number of the member.
- e) Amount authorized.
- f) Date paid. (Date the draft is paid by the credit union.)
- g) Check number of check used to pay the credit union's bank.
- h) Date voided, if such occurs.
- i) Reason for voiding.

Amounts shown in column e. above, which are not followed by entries in columns f. and g., represent the outstanding draft authorizations. The total of these amounts can be checked against the total of the outstanding authorizations, copies of which should be filed in separate folders as indicated above. The register can serve as a subsidiary to the General Ledger control, "Accounts Payable-Drafts Authorized", and the total of the outstanding authorization (open amounts in column e.) should agree with the balance in that account. Likewise, the total of the open amounts in column e. will be the amount of any contingent liability, if applicable.

Responsibility for Funds on Hand to Meet Loan Draft Obligations

Credit union management has a very profound responsibility in connection with draft procedures to assure that the credit union has funds on hand to meet the total amount of cash required for drafts authorized. A credit union maintaining a draft register similar to the one described above will have no difficulty in determining on a current basis the amount of funds needed to satisfy obligations for drafts authorized.

Sale and Redemption of U.S. Savings Bonds

This account should reflect the balance of cash on deposit in a separate bank account established by the credit union for installment payments received on U.S. Savings Bonds.

Section 121 of the Federal Credit Union Act provides that federal credit unions may act as agents

for the U.S. Treasury Department for the sale of U.S. Treasury Bonds and Notes. Only those credit unions that have applied to the U.S. Treasury and have been approved as issuing and/or payment agents may engage in savings bonds and savings note transactions. Both members and nonmembers can participate in these transactions.

When installment payments are received from purchases of U.S. Savings Bonds or Notes, "Cash" should be debited and "Accounts Payable-Installment Payments on U.S. Bonds", should be credited. When sufficient funds are available for the issuance of a bond for any purchaser or purchasers, the bonds should be issued and liability for installments received should be eliminated by debiting the payable account for the purchase price of the bonds and crediting "Accounts Payable-U.S. Savings Bond Remittances".

Illustrative Entries

- a) To record receipts of installment purchases of U.S. Savings Bonds:

Dr.- Cash - U.S. Bond Installment Payments	\$122.50
Cr.- Accounts Payable- Installment Payment on U.S. Bonds	\$122.50

- b) To record the issuance of a fully-paid bond:

Dr.- Accounts Payable- Installment Payment on U.S. Bonds	\$150.00
Cr.- Accounts Payable - U.S. Savings Bond Remittances	\$150.00

- c) To record the cancellation of a bond authorization and pay the subscriber the balance of the installment contract:

Dr.- Accounts Payable - Installment Payment on U.S. Bonds	\$12.50
Cr.- Cash-U.S. Bond Installment	\$12.50

d) To record remittance made to the Federal Reserve Bank for bonds issued under the installment payment plan:

Dr.- Accounts Payable-U.S.	
Savings Bond Remittances	\$150.00
Cr.- Cash	\$150.00

Detailed Transactions

Debit:

a) With cash received representing payments of installments on the purchase of U.S. Savings Bonds.

Credit:

a) With withdrawals by purchaser of deposits made for the purchase of U.S. Savings Bonds.

b) With remittances to the Federal Reserve Bank to cover the cost of bonds issued to installment purchasers.

Bond Sale Transactions/Records

Federal credit unions must properly account for the receipt, sale, and remittance of the proceeds of all bonds sold and for all bonds redeemed.

Federal credit unions engaged in U.S. Savings Bonds transactions will be dealing with both the U.S. Treasury Department and the regional Federal Reserve Bank. Pertinent instructions from both agencies will need to be followed. Adequate safekeeping facilities for the stock of unissued bonds must be provided.

The invoices received from the Federal Reserve Bank may be used as a record of the U.S. Savings Bonds received. The bonds received should be compared with these invoices for correctness of quantity, serial numbers, and denominations. A record of the serial numbers and denominations of spoiled bonds returned to the Federal Reserve Bank must be attached to the advices received from the Federal Reserve Bank acknowledging the receipt of the spoiled bonds. Both the invoices and the ad-

vices must be retained as a part of the records of the credit union.

The accounting discussion and illustrations below refer to the use of two accounts: (1) "Accounts Payable, U.S. Savings Bonds Remittances", which is for use in recording the liability where the full purchase price has been received and bonds issued, but funds have not yet been remitted to the Federal Reserve Bank; and (2) Accounts Payable, Installment Payments on U.S. Bonds, to record the installment payments received toward the purchase of bonds, where the full purchase price has not yet been received and/or the bonds have not been issued.

Separate accounts may be established for each type of bonds purchased. It is essential that accurate subsidiary records be kept to support the individual purchases or installment payments made by each individual and the bonds issued to these individuals.

Cash Received from Sales of U.S. Savings Bonds

A Treasury Department form "Application for United States Savings Bonds" which is furnished by the Federal Reserve Bank, should be used to record cash received from each sale of bonds, and this form may be used in place of the Cash Received Voucher if desired.

A form titled, "Record of Cash Received from Sales of U.S. Savings Bonds," provides a memorandum record of each savings bond sold. It also serves as a detailed record in support of the credit balance of "Accounts Payable-U.S. Savings Bond Remittances". This account will reflect the liability of the credit union as an issuing agent for the proceeds received from sales of U.S. Savings Bonds. The credit balance of the account represents the total amount received from sales of bonds which have been issued but on which the funds have not been remitted to the Federal Reserve Bank.

The copy of the registration stub may be used as a substitute for the form titled "Record of Cash Received from Sale of U.S. Savings Bonds", provided that such stubs are filed in a manner which will provide adequate information to prove the credit

union's accountability for bonds received and that all cash for bonds sold has been remitted to the Federal Reserve Bank.

The total of the amounts received, as shown on the "Record of Cash Received from Sale of U.S. Savings Bonds" form or by the unremitted registration stubs (amounts received from sales of bonds issued but which have not been remitted to the Federal Reserve Bank), should equal the credit balance of "Accounts Payable-U.S. Savings Bond Remittances". The total of these amounts should be proved with the balance of this account at the close of each month in the same manner as the Individual Share and Loan Ledger accounts are proved with their control accounts in the General Ledger. The monthly fists of these amounts should be retained.

If a credit union desires to develop its own record of U.S. Savings Bonds sold, the record should contain the following minimum information:

- Date of receipt of cash.
- Name of purchaser.
- Maturity value of bond and bond serial number.
- Amount of proceeds received from each purchaser.
- Date proceeds remitted to Federal Reserve Bank.

Illustrative Entries

a) When the daily total of cash received from sales of fully purchased and issued savings bonds is entered in the Journal and Cash Record (see section titled "Installment Payments" below for installment purchases of savings bonds):

Dr.- Cash	\$75.00
Cr.- Accounts Payable - U.S.	
Savings Bonds Remittances	\$75.00

b) When proceeds received from sales of savings bonds are remitted to the Federal Reserve Bank:

Dr.- Accounts Payable - U.S.	\$75.00
Savings Bonds Remittances	
Cr.- Cash	\$75.00

Payments Received

As a posting medium for entries in the individual accounts and in the Journal and Cash Record, either payroll deduction forms or cash received vouchers may be used. In those credit unions that receive installment payments through payroll deductions, provision may be made on the records already in use to show the deductions applicable toward the purchase of bonds.

Cash received vouchers bearing an appropriate notation of the nature of the collection should be prepared when installment payments are received in cash. If a separate cash account is used for bond installment payments received, the appropriate Cash account column should be used to record the entry in the Journal and Cash Record.

Installment Payments Received over the Counter

Those credit unions collecting installment payments in cash over the counter should provide a receipt for each payment received. The form of receipt may be a duplicate cash received voucher. An installment payment record folder can also be prepared for recording the payments. If memorandum entries have been made in the folder, a notation should be made therein of the date the bond was issued and the amount thereof. If receipts have been given for the installment payments, they should be turned over to the credit union when the bond is issued.

The record of deductions from salaries or wages as furnished by the company to its employees may be regarded as sufficient receipt until such time as the bond is issued.

The credit union should be prepared to furnish any subscriber a statement of installment payments received, if one is requested.

Disbursements

The disbursements should be made by check and should be limited to remittances for bonds issued and to withdrawals by subscribers of installments paid. A person should only be permitted to withdraw these payments prior to their reaching the amount agreed upon for the issuance of a bond, and only then upon termination of employment or the cancellation of the authorization for purchase of bonds either by the person or the credit union. In such an event, the amount of the accumulated payments may be returned and the individual account closed. A receipt should be obtained from the person receiving the accumulated funds. A Journal Voucher may be used for this purpose. This credit union should also obtain for its files a release from the subscribers when authorizations for payroll deductions applicable to bond purchases are canceled.

Liability Account

"Accounts Payable-Installment Payments on U.S. Bonds" should show the liability of the credit union for installment payments received for application toward the purchase of U.S. Savings Bonds. The credit balance of the account should represent the total of such payments received and not yet applied to the purchase of bonds.

The installment payments on U.S. Savings Bonds are not the equivalent of payments on shares and no interest or dividends will be paid thereon. Furthermore, these payments are not to be considered as security for loans and the approval of the credit committee or loan officer for withdrawals is not necessary. This account will be credited with the total of cash received as installment payments on U.S. Savings Bonds as shown by cash summary vouchers or payroll deductions records.

Bonds are issued whenever the installment payments by a subscriber or group of subscribers reach the designated purchase price. Upon issuance of bonds, this account should be debited with the total amount of the sale and "Accounts Payable U.S. Savings Bonds Remittances", should be credited. Entries for bonds issued should also be made in the Record of Cash Received from Sales of U. S. Savings Bonds.

Records of Installment Payments

Credit unions that receive installment payments on bonds through payroll deductions should obtain from the subscribers an authorization for such deductions and for application thereof to the purchase of bonds. The authorization should be addressed to both the employer and the credit union.

The U.S. Treasury issues a standard card form, Payroll Authorization for Purchase of Savings Bonds, which may be used in this connection. Certain changes in the form are necessary to include the credit union as a party to the agreement.

Credit unions receiving installment payments direct from subscribers should, likewise, have an authorization for application of the payments to the purchase of bonds. The U.S. Treasury form will be of assistance in preparing the authorization.

Subsidiary ledgers

Subsidiary ledgers should be established to account for the installment payments received from each person. The individual accounts for installment payment will ordinarily be sold separately from the Individual Share and Loan Ledgers. Postings from the payroll deduction records or cash received vouchers to the individual installment accounts should be made in the same manner as postings to the Individual Share and Loan Ledgers. The individual installment account balances should be totaled at least at the end of each month and balanced with the total shown in General Ledger "Accounts Payable-Installment Payments on U.S. Bonds". The monthly trial balance tapes of the individual accounts should be kept for audit purposes. The ledger forms used should provide the following information:

- Name and address of subscriber.
- Date and amount of payments received.
- Date and amount of withdrawals or amounts applied to issuance of bonds.

- Balance to credit of subscriber.

Savings Bond Redemption Transactions

Credit unions, as paying agents, may redeem savings bonds by check, cash, or by crediting the member's share account. Amounts receivable from the Federal Reserve Bank for such redemptions should be charged to "Accounts Receivable-U.S. Savings Bonds Redeemed".

Payment by Check

Debits to "Accounts Receivable-U.S. Savings Bonds Redeemed", should be made when checks are issued in payment of bonds. Credits should be made when a remittance is received from the Federal Reserve Bank for the value of the various shipments of bonds.

If it is anticipated that bond payments will be handled in volume, or if a volume of such transactions develops, blank columns of the Journal and Cash Record may be used to record the debits and credits of Accounts Receivable - U.S. Savings Bonds Redeemed.

A Journal Voucher should be prepared in connection with each payment of a bond(s) by check. This voucher should show the usual information and, in addition, should show the serial number of the bond(s) paid.

Illustrative Entries

- a) When a check is issued in payment of a savings bond of \$50 denomination and having a current redemption value of \$25:

Dr.- Accounts Payable - U.S.	
Savings Bonds Redeemed	\$25.00
Cr.- Cash	\$25.00

- b) When a remittance is received from the Federal Reserve Bank for the value of paid bonds and notes shipped:

Dr.- Cash	\$175.00
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Cr.- Accounts Receivable - U.S.	
Savings Bonds Redeemed	\$175.00

Payment by Share Credit

A Journal Voucher should be used to record the redemption of a bond(s) by share credit. This voucher should show the usual information and, in addition, show the serial number of the bond(s) paid. All such Journal Vouchers involving share credits for the redemptions may be combined daily on a summary voucher for entry into the Journal and Cash Record.

"Accounts Receivable-U.S. Savings Bonds Redeemed", should be debited for the value of any bonds paid by credit to shares. Posting of the share credit should be made to the member's Individual Share Ledger. Valuable information about savings bonds and savings bonds redemption values can be obtained at www.savingsbonds.gov.

Illustrative Entry

To record payment by the credit union of a savings bond of \$50 denomination and having a current redemption value of \$25, by crediting the member's share account:

Dr.- Accounts Receivable -	
U.S. Savings Bonds Re-	
deemed	\$25.00
Cr.- Shares	\$25.00

Payment in Cash

Payment of bonds may be made in cash if the board of directors of the credit union desires to do so. If the board decides to make these disbursements in cash, it may, by recorded resolution, exercise this option of the standard bylaws.

A journal voucher should be prepared, indicating among other things the person to whom the funds were paid, the amount paid, and the serial number of the bond(s). The fact that the disbursement was made in cash should also be noted and the payee

should sign the voucher in the usual manner. The journal voucher should be held with the bond pending its withdrawal from the change fund. The journal vouchers attached to the bonds withdrawn from the change fund should be detached and summarized to support the entry in the Journal and Cash Record to replenish the change fund.

Illustrative Entry

To record check drawn in replenishment of change fund for bonds paid in cash:

Dr.- Accounts Receivable -	
U.S. Savings Bonds Redeemed	\$381.00
Cr.- Cash	\$381.00

Recording Payment Data

Credit unions will be required to record certain payment information on the face of bonds paid. Among the required items are the amount paid, the paying agent's name, the date of payment, and who approved or made payment. The method of payment, such as cash or check (include check no.), share credit and any other pertinent information can be noted on the back of the bond.

Shipment of Paid Bonds

Shipment of paid bonds to the Federal Reserve Bank should be supported by letters of transmittal in accordance with instructions from the bank. It will be preferable for purposes of identification and balancing of accounts to have the shipments include all bonds paid on one or more business days.

The debit balance in "Accounts Receivable-U.S. Savings Bonds Redeemed", at any given date should represent that total value of redeemed bonds on hand plus the value of bonds shipped to the Federal Reserve Bank for which remittance has not been received.

Copies of letters transmitting shipments of bonds should be retained and filed. One file should include copies of letters on shipments for which re-

mittance has been received and another file should include letters covering shipments for which payment has not been made by the bank. The file on shipments not paid for and the redeemed bonds on hand pending shipment will constitute the support for the General Ledger Account, Accounts Receivable - U.S. Savings Bonds Redeemed.

Compensation for Services

The compensation received by the credit union for serving as a paying agent should be credited to "Other Operating Income". This credit should be made at the time the remittance is received.

CASH EQUIVALENTS

Cash equivalents are short-term, highly liquid investments that are both readily convertible to known amounts of cash and so near their maturity that they present insignificant risk of changes in value because of changes in interest rates.

For purposes of this section, generally, only investments with original maturities of three (3) months or less qualify as a cash equivalent.

Examples of items commonly considered to be cash equivalents are Fed funds sold, treasury bills, commercial paper, money market funds, certificates of deposit (3 months or less maturity), and other highly liquid investments in banks, S&L's, and corporate credit unions.

Note: The treatment of cash equivalents in the Statement of Cash flows may differ from the classification used here in the Statement of Financial condition.

Federal Funds Sold

A sale of Federal Funds occurs when a Federal credit union transfers immediately available funds to a bank and the bank agrees to repay the funds to the Federal credit union one or more business days later. The funds may be transferred to the bank by any method, including from an account maintained at the bank by the credit union. The agreement to repay may have a specific maturity date or may be open-ended. The funds are unsecured and are gen-

erally loaned overnight (or over a weekend) at the market rate for Federal Funds transactions. Federal fund investments generally represent very liquid funds, and the credit union is able to require repayment at anytime. An open-ended agreement has no specific maturity date. It requires, however, repayment on any date that is specified by either the Federal credit union or the bank. A sale is considered as a deposit which can be made in accordance with Section 107(8) of the Act.

General Comments

In order that sales of Federal Funds are conducted in a safe and sound manner: (1) the credit union itself should transfer the funds to the bank; and (2) consideration should not be received from a third party. A Federal funds transaction is not subject to Regulation Q limitations or to the Regulation D reserve requirements.

Accounting Entries

A sale of Federal Funds will be recorded as a deposit in "Other Investments", which is a debit balance account.

- a) To record investments in Fed funds:

Dr.-Other Investments	\$80,000	
Cr.- Cash		\$80,000

- b) To record the sale of Fed funds:

Dr.- Cash	\$80,000	
Cr.- Other Investments		\$80,000

Treasury Bills

Represent short-term (3 months or less) U.S. Government obligations. For accounting discussion and examples, refer to the Investment section.

Commercial Paper

Represents short-term (3 months or less) corporate obligations that is unsecured and should be highly rated by top rated entities including Standard & Poors, Moody's, etc.

Accounting Considerations

Interest expense for the issuer and income for the investor are based on the coupon, if issued at face value, or accretion of the discount, if issued at a discount.

Shares/Deposits/Certificates in Commercial Banks, S&L's, Savings Banks

For purposes of this section, this represents investments at these type institutions that have an original maturity of 3 months or less. For more detailed accounting procedures, refer to this area in the Investment section.

Shares/Deposits/Certificates in Corporate Credit Unions

For purposes of this section, this represents investments at corporate credit unions that have an original maturity of 3 months or less. For more detailed accounting procedures, refer to this area in the Investment section.

Certificates of Deposit

A certificate of deposit represents a short-term debt obligation issued by a bank, thrift, credit union, etc. For purposes of this section, certificate of deposits with an original maturity of 3 months or less qualify as a cash equivalent.

Accounting Considerations

Interest expense for the issuer and income for the investor are based on the coupon if issued at face or accretion of the discount if issued at a discount.

All Other Investments

For purposes of this section, this represents investments at "Other Credit Unions" that have an original maturity of 3 months or less. For more detailed accounting procedures, refer to this area in the Investment section.

Traveler's Checks/Money Orders

A credit union may also have consignment items (such as travelers' checks and money orders) that could easily be converted into cash.

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INVESTMENTS

This section discusses investments and accounting for investments. In general, investments are limited to those authorized by Section 107 of the Federal Credit Union Act (the Act) and Part 703 of the National Credit Union Administration Rules and Regulations. Rather than repeat the section and part here, we refer you to the above referenced documents for examples of the types of investments permissible for federal credit unions.

SECURITIES

Generally accepted accounting principles (GAAP) defines a security as a

“share, participation, or other interest in property or in an enterprise of the issuer or an obligation of the issuer that (a) either is represented

by an instrument issued in bearer or registered form or, if not represented by an instrument, is registered in books maintained to record transfers by or on behalf of the issuer, (b) is of a type commonly dealt in on securities exchanges or markets or, when represented by an instrument, is commonly recognized in any area in which it is issued or dealt in as a medium for investment, and (c) either is one of a class or series or by its terms is divisible into a class or series of shares, participations, interests, or obligations.”

When securities are acquired, a credit union must assess its intent and ability and assign its debt and equity securities to the appropriate measurement category: *trading*, *held-to-maturity*, or *available-for-sale*. Securities not classified as *trading*, and not

meeting the requirements of *held-to-maturity* shall be classified as *available-for-sale* (AFS). Not less frequently than the end of each dividend period, (i.e., monthly, quarterly, semi-annually, or annually), the appropriateness of the classifications, and the reasonableness and accuracy of the related fair value measurement (*trading* and *available-for-sale*), shall be assessed.

Reporting requirements shall be as follows:

- *Debt and equity* securities that are bought and held principally for the purpose of selling them in the near term shall be classified as *trading securities* and reported at fair value through the income statement.
- *Debt* securities (not equity) that the enterprise has the positive intent and ability to hold to maturity shall be classified as securities *held-to-maturity* and reported at amortized cost.
- *Debt and equity* securities not classified as either securities *trading* or *held-to-maturity* securities shall be classified as securities *available-for-sale* and reported at fair value through a separate component of equity in the balance sheet, *Accumulated Unrealized Gains/Losses on Available-for-Sale Securities*.

A credit union shall consider GAAP in how it plans to manage its holdings of securities when designating individual securities as trading, *held-to-maturity* or *available-for-sale*. Credit unions which use an outside independent accountant are encouraged to consult them when assigning their securities to the measurement categories. There is no specified percentage or amount of securities that a credit union must assign to each category. Rather, the amount of securities a credit union assigns to each of the three categories depends on the facts and circumstances surrounding the credit union and the actual securities it owns.

A credit union shall have adequate documentation to support the initial assignment of securities to the three categories, the assignments made when securities are purchased, and the periodic evaluations (not less frequently than the end of each dividend period) of the continuing appropriateness of these assignments. The amount and types of documentation to support the

assignment of securities to the measurement categories will vary from credit union to credit union based on its size and the complexity of its operations, including the nature and scope of its securities activities. A credit union's documentation may include its:

- Written and approved investment policies and strategies,
- Policies governing liquidity and funds management and interest rate risk management,
- Board or committee minutes,
- Budgets,
- Cash flow projections,
- Capital plans, and
- Memorandums discussing the purposes or reasons for purchasing particular securities.

In addition, a credit union's history of holding specific types of securities to maturity can be a form of documentation. A credit union's management shall recognize that GAAP envisions that sale and transfer out of the *held-to-maturity* category generally should be rare and that any such transactions may raise questions about the appropriateness of the credit union's designation of other securities as *held-to-maturity*.

Trading Securities

This account records the purchase, sale, and adjustments of trading securities to fair value.

Debt and equity securities that are bought and held principally for the purpose of selling them in the near term are classified as *trading securities* and reported at fair value through the income statement. Characteristic of trading is active and frequent buying and selling, and *trading* securities are generally used with the objective of generating profits on short-term differences in price. Unrealized holding gains and losses for *trading* securities are included in the income statement. Dividend and interest income, including amortization of premium and discount, are included in the income statement.

Illustrative Entries

- a) To record purchase of trading securities:

Dr.- Trading Securities	\$150,000	
Cr.- Cash		\$150,000

- b) To record increase in fair value (opposite entry to record decrease in fair value):

Dr.- Trading Securities	\$5,000	
Cr.- Trading Profits and Losses		\$5,000

- c) To record interest earned on trading securities:

Dr.- Cash	\$9,000	
Cr.- Interest on Trading Securities		\$9,000

- d) To record the sale of the security at fair value:

Dr.- Cash	\$155,000	
Cr.- Trading Securities		\$155,000

Detailed TransactionsDebit:

- a) With the purchase of trading securities.
- b) With the periodic write-up of trading securities to fair value.

Credit:

- a) With the sale of trading securities.
- b) With the periodic write-down of trading securities to fair value.

Securities Available-For-Sale

This account is used to record available-for-sale securities (AFS). Securities not classified as *trading* and not meeting the requirements of *held-to-maturity* shall be classified as securities *available-for-sale* (AFS). Debt and equity securities classified as AFS are reported at fair value through a separate component of

equity (Other Comprehensive Income) in the balance sheet, Accumulated *Unrealized Gains/Losses on AFS*.

For credit union boards, in particular, fair value measurement gives them the information they need to oversee their credit unions. If securities in the AFS portfolio drop in fair value below book value, a credit union board will have a ready indicator of this decline in the balance sheet separate equity account. Fair value measurement is a tool credit union management, credit union boards, and regulatory staff need to ensure the safety and soundness of credit unions. Adjustments shall be made directly to the investment account. Unrealized holding gains and losses shall be excluded from the income statement and reported as a net amount in a separate component of equity (other comprehensive income) on the balance sheet until realized. Dividend and interest income, including amortization of premium and discount, shall continue to be included in the income statement.

Premiums and Discounts

Credit unions often purchase AFS investments at a premium or a discount. Credit unions should account for the premium and/or discount using the interest method and include the amortization of the premium and/or discount in the income statement. GAAP does permit straight-line or other alternative methods if the results do not vary materially from those obtained using the interest rate method.

The mechanics of accounting for the premiums or discounts on available-for-sale investments differs slightly from the accounting for the premiums or discounts on held-to-maturity investments. An accounting difference exists because credit unions must account for market fluctuations on available-for-sale investments in conjunction with the associated premium or discount. The following examples should provide additional information and relevant entries.

- The first set of entries details the method required under GAAP when purchasing AFS securities at a discount.
- Subsequently, for comparison purposes, the same entries are shown side by side for HTM and AFS securities.
- The third set of entries details the common practice in credit unions for the accounting of premi-

ums and discounts on AFS securities. This method may be used if not resulting in material misstatement.

Illustrative Entries:

On 06/30/01, the credit union purchases a U.S. Treasury obligation \$100,000 par, at a discount of \$6,657.50. Assume the Treasury note has a nominal rate of 7 percent with a semiannual coupon payment. The annual yield to maturity is 8 percent, or 4 percent per coupon period.

On 12/31/2001, market conditions change and the fair value of the investment increases to \$102,000.

On 6/30/02, the market changes again and the fair value declines to \$92,000.

Using the interest method to accrete the discount, the accretion table below was developed. The following illustrates the appropriate entries and/or additional explanation:

a) At time of purchase, the credit union would make the following entry and develop an amortization table that is illustrated on below:

Dr.- AFS	\$93,342.50
Cr.- Cash	\$93,342.50

b) To record the unrealized gain and interest income received on 12/31/01.

Dr.- AFS	\$8,657.50
Dr.- Cash	3,500.00
Cr.- Investment Income	\$3,733.70
Cr.- Unrealized Gain on AFS	8,423.80

c) To record the unrealized loss and the interest income received on 6/30/02.

Dr.- Unrealized Loss	
on AFS	\$10,243.05
Dr.- Cash	3,500.00
Cr.- Investment Income	\$3,743.05
Cr.- AFS	10,000.00

Period	7% Coupon Interest (a)	8% Effective Interest (b)	Accretion Amount (c)	Carrying Amount (d)	Discount	Par Value
6/30/01				\$93,342.50	\$6,657.50	\$100,000
12/31/01	\$3,500	\$3,733.70	\$233.70	93,576.20	6,423.80	
6/30/02	3,500	3,743.05	243.05	93,819.25	6,180.75	
12/31/02	3,500	3,752.77	252.77	94,072.02	5,927.78	

(a) = 7% divided by 2 periods/year x \$100,000.

(b) = 8% divided by 2 periods/year x d.

(c) = (b) - (a).

(d) = Previous (d) balance + (c).

\$233.70 x 73/184 days (Table above)

Comparison Entries (continued):

To build on this example, the following table compares the accounting entries necessary to account for

identical securities; however, classified differently: held-to-maturity (HTM) as compared to available-for-sale (AFS). For more on HTM securities, see the section following this one. Notice the recognition of income (derived from the amortization of the dis-

count) and the adjustment of AFS to fair value (AFS). The AFS entries (right column) used as a basis for comparison are identical to those above.

Held-to-Maturity (HTM)	Available For Sale (AFS)
1. Purchase of Security 6/30/01:	1. Purchase of Security 6/30/01:
HTM Securities \$100,000	AFS \$93,342.50
Discount on HTM Securities \$6,657.50	Cash \$93,342.50
Cash 93,342.50	
2. To record the interest income received on 12/31/01 and the accretion of the discount on the HTM security.	2. To record the interest income received on 12/31/01 while accreting the discount and the unrealized gain on the AFS security.
Cash \$3,500.00	Cash \$3,500.00
Discount on HTM 233.70	AFS 8,657.50
Investment Income 3,733.70	Investment Income \$3,733.70
	Unrealized Gain On AFS 8,423.80
3. To record the interest income received on 06/30/02 and the accretion of the discount on the HTM security.	3. To record the unrealized loss and the interest income received on 6/30/02 considering the accretion of the discount.
Cash \$3,500.00	Cash \$3,500.00
Discount on HTM \$243.05	Unrealized Loss On AFS 10,243.05
Investment Income \$3,743.05	Investment Income \$3,743.05
	AFS 10,000.00

AFS Note: In each instance, the credit union should balance back to the carrying value (i.e., column d) of the investment depicted in the above accretion table.

Illustrative Entries Available For Sale (AFS) (continued):

-- Common Credit Union Practice when AFS Purchased at a Discount --Repeating Above Example

Note: This approach is often seen in practice. It results in the proper GAAP valuation ultimately, but does not comply with GAAP in financial statement

presentation. Examiners will urge you to move to the GAAP approach discussed previously because of the incorrect use of a contra asset account (see c)) in this developed practice approach.

a) Purchase of Security 6/30/01:

Dr.- AFS	\$100,000	
Cr.- Discount on AFS		\$6,657.50

Cr.- Cash 93,342.50

b) To record the interest income received on 12/31/01 while accreting the discount on the AFS security.

Dr.- Cash \$3,500.00
Dr.- Discount on AFS 233.70
Cr.- Investment Income \$3,733.70

c) To adjust AFS to \$102,000 fair value:

Dr.-Contra Asset
Mark to FV Account \$8,423.80
Cr.- Accumulated Unrealized G/L on AFS \$8,423.80

*--Net value of AFS:
AFS \$100,000.00
Discount on AFS (6,423.80)
Contra Asset Mark to FV Account 8,423.8
\$102,000

d) To record the interest income received on 06/30/02 and the accretion of the discount on the AFS security.

Dr.- Cash \$3,500.00
Dr.- Discount on AFS 243.05
Cr.- Investment Income \$3,743.05

e) To adjust AFS to \$92,000 fair value:

Dr.- Unrealized Gains/Losses on AFS \$10,243.05
Cr.- Contra Asset Mark to FV Account \$10,243.05

*--Net value of AFS:
AFS \$100,000.00
Discount on AFS (6,180.75)
Contra Asset Mark to FV Account (1,819.25)
\$92,000

Mutual Funds are considered to be marketable equity securities. The fair value of a mutual fund investment is readily determinable and published, and is the basis for current transactions. An investment in a mutual fund must be classified in either the *Available-for-*

Sale or Trading categories. Adjustments shall be made directly to the investment account; no allowance for investment losses account or related provision shall be used.

Illustrative Entries (Assume Mutual Fund):

a) When the credit union invests in an AFS security:

Dr.- AFS \$10,000
Cr.- Cash \$10,000

b) When income on an AFS is reinvested and credited by the fund manager to the account of the investing credit union:

Dr.- AFS \$500.00
Cr.- Income from AFS \$500.00

c) When the credit union marks the investment to \$11,500 fair value:

Dr.- AFS \$1,000.00
Cr.- Accumulated Unrealized G/L on AFS \$1,000.00

d) When the credit union withdraws its investment in the mutual fund receiving \$10,300:

Dr.- Cash \$10,300.00
Dr.- Accumulated Unrealized G/L on AFS 1,000.00
Dr.- Loss on Disposition of Investments 200.00
Cr.- AFS Securities \$11,500.00

Note: Unrealized gains or losses on AFS are reversed upon disposition and the accumulated net amount realized through the income statement.

Detailed Transactions for AFS

Debit:

a) With amounts of each security classified as available-for-sale.

- b) With amounts of write-ups to fair value.
- c) With income reinvested in the equity security by the fund manager, based on periodic advices of income received from the trust.

Credit:

- a) With amounts of write-downs to fair value.
- b) With amounts of withdrawals from equity securities.

Securities Held-To-Maturity

This account is used to record all securities for which the credit union has the intent and ability to hold to maturity. Types of securities properly recorded in this account include obligations of the United States of America or securities that are fully guaranteed as to both principal and interest thereby:

- a) Appreciation type, U.S. Government Obligations are generally purchased at a discount. Income is recorded periodically through accretion of discount (systematic reduction of discount by charge to income) and based on tables of redemption provided by the U.S. Treasury. By the manner in which income is earned, zero coupon bonds are a special class of “appreciation type” obligations.
- b) Current income type. The U.S. Government Obligation is purchased at face value (par value) and a uniform interest rate is paid semiannually by check during the life of the savings bond.
- c) General type of obligations. These U.S. Government Obligations are purchased on the open market or subscribed for at the time of the original issue. They may be registered with periodic interest checks being sent to the credit union, or interest may be received by cashing coupons that mature at stated intervals.
- d) Also included are so-called “agency” securities and participation certificates as permitted by the Federal Credit Union Act. The “agency” securities are bonds, notes and debentures issued by agencies of the United States Government and secured by collateral owned by these agencies. They are not guaranteed by the United States. Information about

“agency” securities can be obtained from banks as well as from dealers in securities. The Federal Reserve bulletin publishes a list of securities outstanding by each agency. “Agency” securities may be purchased on the open market. Information on participation certificates can be obtained by contacting the Government National Mortgage Association, the Federal Home Loan Mortgage Corporation or the Federal National Mortgage Association.

When a credit union acquires a security, it should assess its intent and ability to hold to these securities and assign its debt and equity securities to the appropriate measurement category: held-to-maturity available-for-sale, or trading. Not less frequently than the end of each dividend period (i.e., monthly, quarterly, semi-annually, or annually), the appropriateness of the classifications, and the reasonableness and accuracy of the related fair value measurement (trading and available-for-sale) shall be assessed.

Debt securities that the credit union has the positive intent and ability to hold to maturity shall be classified as securities held-to-maturity and reported at amortized cost, i.e., cost adjusted for the amortization of premiums or the accretion of discounts. To qualify as having established intent to hold to maturity, the credit union cannot have an intent to hold the security only for an indefinite period. The credit union has failed to meet the “hold-to-maturity” test if a security is sold due to the following:

- Changes in market interest rates and related changes in prepayment risk,
- Need for liquidity,
- Changes in funding sources and terms,
- Changes in the availability of and the yield on alternative security, etc.

A credit union’s alternatives are to classify the security as either *available-for-sale* or in a *trading account*.

Through an established and documented asset-liability management (ALM) strategy, a credit union may decide that it can accomplish its ALM strategic plans/goals without having all of its debt securities classified available-for-sale. Measurement standards

acknowledge that even though a credit union considers the maturity and re-pricing characteristics of all of its debt securities as part of its asset-liability management, the credit union may determine that it can carry out the ongoing adjustments to its asset-liability position without having all of its debt securities *available-for-sale*. In such a situation, the credit union may earmark specific debt securities as unavailable to be sold for purposes of adjusting its asset-liability position. This would enable the earmarked securities to be placed in the *held-to-maturity* category provided the credit union otherwise has the positive intent and ability to hold them to maturity.

A credit union could experience any of the following “changes in circumstances” which may cause a credit union to sell or transfer a *held-to-maturity* security to another classification without raising questions about whether it was appropriate for that security to have been reported previously as *held-to-maturity*:

- a) A significant deterioration in the issuer’s credit-worthiness.
- b) A merger, purchase and assumption, or other business combination that necessitates the sale or transfer of *held-to-maturity* securities to maintain the credit union’s existing interest-rate risk position or credit risk policy.
- c) A change in statutory or regulatory requirements causing the credit union to dispose of a held-to-maturity security (e.g., mandated change to risk based capital reserving structure).
- d) A significant increase by the regulator in capital requirements that causes the credit union to downsize by selling held-to-maturity securities.

Additionally, a credit union can successfully defend the sale of a *held-to-maturity* security, prior to maturity, under either of the two conditions:

- a) The sale is so near the maturity date (e.g., within three months) that the security’s value is little affected by changes in market interest rates.
- b) The sale occurs after the credit union has already collected a substantial portion (e.g., 85 percent or more) of the principal outstanding at acquisition.

Reverse repurchase and repurchase arrangements do not in and of themselves preclude a credit union from placing such securities in the *held-to-maturity* category, provided the credit union otherwise has the positive intent and ability to hold the securities to maturity. Furthermore, if, at the point of purchase of a CMO, a credit union can demonstrate that all probable future liquidity needs can be met through the sale of other securities, then the classification of the CMO as *held to maturity* will be accepted.

Detailed subsidiary records should be kept of held-to-maturity securities by type of security, including individual tracking of related cost, discounts and premiums, and fair value. Periodic reconciliation of the subsidiary records to this control account must be made.

Premiums and Discounts

Securities may be acquired at a premium, a price in excess of face value, or at a discount, a price less than face value. When a U.S. Government Obligation is purchased, the par value of the security should be recorded, as well as any discount or premium associated with this purchase. For presentation on the Statement of Financial Condition, discounts should be deducted from, and premiums should be added to the par value of the investment with the net amount being reflected in the balance of “Held-to-Maturity Securities”.

If the securities are purchased at a premium, the premium should be amortized over the period from date of acquisition to maturity. If the securities are purchased at a discount, the discount should be accreted under the theory that the securities normally can be expected to increase in market value over their remaining life.

There are two popular methods of amortizing premiums and accreting discounts: the straight-line method and the interest method. The straight-line method results in equal periodic adjustments to earnings from the time of purchase to the maturity date. This method is simple to compute and affects earnings by the same amount each period.

Interest Method Of Amortization

The interest method recognizes an amount in earnings each period that produces a constant yield equal to the

market yield at the date of purchase. Under this method, the amount of discount accreted or premium amortized increases or decreases, respectively, each period so that over the course of holding the investment, a level yield on the investment is maintained.

The interest method of accreting discount or amortizing premium should be used unless the results obtained when using the straight-line method or other methods of amortization or accretion do not vary materially from those that would be obtained by the interest method.

GAAP requires management to consider several factors when amortizing a premium or accreting a discount. If a credit union maintains investments for which prepayments are probable and the timing and the amount of prepayments can be reasonably estimated (e.g., Bloomberg), credit union management should consider estimates of future principal prepayments in the interest method calculation. If the credit union anticipates prepayments in applying the interest method and a difference arises between the prepayments anticipated and actual prepayments received, management should recalculate the effective yield to reflect actual payments to date and anticipated future payments. The net investment should be adjusted to the amount that would have existed had the new effective yield been applied since the acquisition of the investment.

Generally accepted accounting principles (GAAP) recommend that the amortization of premium and accretion of discount be recorded in a manner that produces a constant rate of return on the basis of adjusted book value. This constant rate of return is achieved through the interest method. GAAP permits straight line or other alternative methods if the results obtained do not vary materially from those obtained using the interest method. However, management should periodically compare their alternative method to the interest method in order to ensure that no material differences exist.

The interest method is applicable to several areas under GAAP. The investment area is one of the areas that benefits through application of the interest method. The interest method would be applicable for securities that are purchased at a premium (a price greater than par) or discount (a price less than the face value).

Credit union management could understate and/or overstate its investment portfolio by not properly applying the interest method. Therefore, credit union management should review the information pertaining to this methodology outlined in this *Manual* or by a thorough review of GAAP literature. If application of the methodology remains unclear, the credit union should seek the guidance of an independent accountant.

Posting to the General Ledger

Entries to this account are posted individually from the "Miscellaneous" columns of the Journal and Cash Record.

Identification of Securities

Securities purchased and disposed of should be clearly identified in the "Explanatory Remarks" column of the General Ledger account. It is desirable to have a record of the name of the issue, the interest rate, the maturity and the serial numbers of the securities owned, and sold, so that this account will show the actual holdings of the credit union, and thus make verification easier. If there are several investments, subsidiary ledgers should be used.

Illustrative Entries:

Purchase of a U.S. Treasury obligation between interest dates, \$100,000 par, at a discount of \$6,657.50, paying \$95,453.91 which includes accrued interest of \$2,111.41.

(Note: The credit union is charged the cost of the obligation plus accrued interest income from the last interest date, 6/30/01, to the purchase date, 10/19/01.)

Assume the Treasury note has a nominal rate of 7 percent with a semiannual coupon payment. The annual yield to maturity is 8 percent, or 4 percent per coupon period.

Using the interest method to accrete the discount, the accretion table below was developed. The following illustrates the appropriate entries and/or additional explanation:

Period	7% Coupon Interest (a)	8% Effective Interest (b)	Accretion Amount (c)	Carrying Amount (d)	Discount	Par Value
10/19/01				\$93,342.50	\$6,657.50	\$100,000
12/31/01	\$3,500	\$3,733.70	\$233.70	93,576.20	6,423.80	
6/30/02	3,500	3,743.05	243.05	93,819.25	6,180.75	
12/31/02	3,500	3,752.77	252.77	94,072.02	5,927.78	

(a) = 7% divided by 2 periods/year x \$100,000.

(b) = 8% divided by 2 periods/year x d.

(c) = (b) - (a).

(d) = Previous (d) balance + (c).

a) Purchase of a U.S. Treasury obligation between interest dates:

Dr.- HTM Securities	\$100,000.00
Dr.- Purchased Accrued Interest Receivable on HTM securities	2,111.41
Cr.- Cash	\$95,453.91
Cr.- Discount on HTM Securities	6,657.50

Dr.- Discount on HTM Securities	\$ 121.52
Dr.- Accrued Income from Investments	1,750.00
Cr.- Income from U.S. Government Obligations	\$1,871.52

b) To record the receipt of interest on 12/31/01 and the accretion of the discount, 10/20/01 through 12/31/01:

Dr.- Cash	\$3,500.00
Dr.- Discount on HTM Securities	92.72*
Cr.- Income from U.S. Government Obligations	\$1,481.31
Cr.- Purchased Accrued Interest receivable on HTM securities	2,111.41

* \$233.70 x 73/184 days=\$92.72

c) To accrue income and accrete the discount for the period, 1/1/02 through 3/31/02:

d) To record the receipt of interest on 6/30/02 and the accretion of the discount, 4/1/02 through 6/30/02:

Dr.- Cash	\$3,500.00
Dr.- Discount on HTM Securities	121.52
Cr.- Income from U.S. Government Obligations	\$1,871.52
Cr.- Accrued Income from Investments	1,750.00

e) To record the sale of the U.S. Treasury Obligations on 9/30/02 @ \$94,500.00. (Note: Generally, an obligation of this type would be held longer than 11 1/2 months; this example is for illustrative purposes only.)

First, record the interest receivable from 7/1 to 9/30/02 and the associated accretion of the discount:

Dr.- Accrued Income from Investments	\$1,750.00
Dr.- Discount on HTM Securities	126.38
Cr.- Income from U.S. Gov- ernment Obligations	\$1,876.38

Next, record the sale entry:

Dr.- Cash	\$96,250.00
Dr.- Discount on HTM Securities	6,054.37
Cr.- HTM Securities	\$100,000.00
Cr.- Accrued Income on Investments	1,750.00
Cr.- Gains on Investments	554.37

Note: The cash received equals the sales price (\$94,500) plus accrued interest receivable (\$1,750).

Look to next table for the following entries:

f) *Purchase of a U.S. Treasury obligation between interest dates, \$100,000 par, at a premium of \$5,444.18, paying \$107,860.22 which includes accrued interest of \$2,416.04.*

(Note: The credit union is charged for the cost of the obligation plus accrued interest income from the last interest date, 6/30/01, to the purchase date, 10/19/01.)

Assume the Treasury note has a nominal rate of 8 percent with a semiannual coupon payment. The annual yield to maturity is 7 percent, or 3.5 percent per coupon period.

Using the interest method to amortize the premium, the amortization table and entry would be as follows:

Period	8% Coupon Interest (a)	7% Effective Interest (b)	Amortization Amount (c)	Carrying Amount (d)	Premium	Par Value
10/19/01				\$105,444.18	\$5,444.18	\$100,000
12/31/01	\$4,000	\$3,690.55	\$309.45	105,134.73	5,134.73	
6/30/02	4,000	3,679.71	320.28	104,814.45	4,814.45	
12/31/02	4,000	3668.50	331.49	104,482.96	4,482.96	

(a) = 8% divided by 2 periods/year x \$100,000.

(b) = 7% divided by 2 periods/year x (d).

(c) = (a) - (b).

(d) = Previous, balance (d) - (c).

* - \$309.45 (Table, Column (c) - 73/184 days

Dr.- HTM Security	\$100,000.00
Dr.- Accrued Income from Investments	2,416.04
Dr.- Premium on HTM Securities	5,444.18
Cr.- Cash	\$107,860.22

g) To record the receipt of interest on 12/31/01 and the amortization of the premium, 10/20/01 through 12/31/01:

Dr.- Cash	\$4,000.00
Cr.- Income from U.S. Government Obligations	\$1,461.19
Cr.- Premium on HTM Securities	122.77
Cr.- Accrued Income from Investments	2,416.04

h) To accrue income and amortize the premium for the period, 1/1/02 through 3/31/02:

Dr.- Accrued Income on Investments	\$2,000.00
Cr.- Income from U.S. Government Obligations	\$1,839.86
Cr.- Premium on HTM Securities	160.14

i) To record the receipt of interest on 6/30/02 and the amortization of the premium, 4/1/02 through 6/30/02:

Dr.- Cash	\$4,000.00
Cr.- Income from U.S. Government Obligations	\$1,839.86
Cr.- Premium on HTM Securities	160.14
Cr.- Accrued Income from Investments	2,000.00

Journal entries similar to bullet (g) and bullet (i) should be made on a continuing basis each dividend period until the U.S. Government Obligations are sold or redeemed.

Illustrative Entries (continued):

Purchase of a collateralized mortgage obligation (CMO) for \$10,000,000 par, at a discount of \$200,000. The investment specifies equal annual payments with no penalty for prepayments. The credit union decides to account for this investment using the anticipated prepayment patterns to apply

the interest method of amortization. The credit union estimates a constant prepayment rate of 6 percent per year based on the current and foreseeable economic conditions. In years 1 and 2, the investment actually prepays at a rate of 6 percent. Based on new information (e.g., market conditions), the credit union revises its estimate of prepayment experience to anticipate that 10 percent of the investment will repay in year 4 and that 6 percent of the investment will repay in the remaining years.***

The credit union would record the initial investment as stated in prior sections. When management calculates the effective yield in year 3 and adjusts the carrying value as if the new yield had been applied since acquisition, the cumulative effect of this adjustment is recognized in current period income. The following represents the adjusting entry of \$8,876 to be recorded as the credit union revises its original estimation of prepayments. If the credit union had not reevaluated the prepayment assumptions, management would have been forced to make a substantial adjusting entry at the conclusion of this investment. Please note that an adjustment would have been also required if the level of prepayments realized was less than anticipated.

Dr.- Discount on Investments	\$8,876	
Cr.- Investment Income		\$8,876

***-Example borrowed, in part, with permission from the Financial Accounting Standards Board, Statement No. 91.

Year	Cash (Out) Inflow	Stated Interest (10%)	Amortization	Interest Income	Remaining Principal	Unamortized Discount	Carrying Amount
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
	(\$9,800,000)				\$10,000,000		
1	2,227,454	\$1,000,000	\$35,141	\$1,035,141	8,772,546	\$164,859	\$8,607,687
2	2,049,623	877,255	31,946	909,201	7,600,178	132,913	7,467,265
3	2,944,644	760,018	41,951	801,969	5,415,552	90,962	5,324,590
4	1,653,939	541,555	23,294	564,849	4,303,168	67,668	4,235,500
5	1,246,229	430,317	18,998	449,315	3,487,256	48,670	3,438,586
6	1,129,164	348,726	16,050	364,776	2,706,818	32,620	2,674,198
7	1,016,331	270,682	13,050	283,687	1,961,169	19,615	1,941,554
8	906,285	196,117	9,849	205,966	1,251,001	9,766	1,241,235
9	795,875	125,100	6,574	131,674	580,226	3,192	577,034
10	638,249	58,023	3,192	61,215	0	0	0
	Total Amortization		\$200,000				

*** Note: The above table appeared in FAS 91 and was reprinted with the permission of the FASB.

Computations:

Column (1) – Contractual payments + prepayments

Column (2) – Column (5) for prior year x the loan's stated interest rate (10%)

Column (3) – Column (4) - Column (2)

Column (4) – Column (7) for the prior year x the effective interest rate (10.5627% for years 1 and 2, and 10.6083% for years 3-10, + an adjustment of \$8,876 in year 3 representing the cumulative effects applicable to year 1 to 2 of changing the estimated effective rate.

Column (5) – Column (5) for prior year - (Column (1) - Column (2))

Column (7) – Column (5) - Column (6)

OTHER SECURITY CONSIDERATIONS

Transfers Between Categories

Transfers between categories shall be accounted for at fair value with unrealized holding gains or losses accounted for as shown in the table which follows. Transfers into and out of the *held-to-maturity* category should be rare. Furthermore, a decision to designate a security as *held-to-maturity* may affect a credit union's ability to freely transfer or sell the security. Transfers out of the *held-to-maturity* cate-

gory by definition jeopardize a credit union's ongoing ability to carry any securities as *held-to-maturity* at amortized cost. As a result, a credit union's initial designation of its securities may adversely affect the degree of flexibility it has to manage its securities portfolio as a secondary source of liquidity.

Given the nature of a *trading* account, transfers into or out of the *trading* category should also be rare.

Investment Transferred From/To:	Transfer at:	Unrealized Holding Gain or Loss
<u>From</u> Trading category	Fair Value	Already recognized in earnings and shall not be reversed
<u>To</u> Trading category	Fair Value	Recognized in earnings immediately
<u>To</u> Available-for-sale category <u>from</u> Held-to-maturity category	Fair Value	Separate component of shareholder's equity
<u>To</u> Held-to-maturity category <u>from</u> the Available-for-sale category	Fair Value	Continue reporting as a separate component of shareholders' equity but begin amortization over the remaining life of the security as an adjustment of yield in a manner consistent with the amortization of any premium or discount.

Impairment of Securities

If the credit union experiences a decline in either an *available-for-sale* or *held-to-maturity* security's value which is *other-than-temporary*, the cost basis of the individual security shall be written down to fair value as a new cost basis and the write-down included in the income statement as a realized loss. An other-than-temporary impairment should be considered to have occurred if it is probable that the investor will be unable to collect all amounts due according to the contractual terms of a debt security not impaired at acquisition. The new cost basis shall not be changed for subsequent recoveries in fair value.

Definitions

Certain investment transactions and activities defined below may or may not be permissible for federal credit unions in accordance with Sections 107(7) and 107(8) of the Federal Credit Union and Part 703 of the National Credit Union Administration Rules and Regulations. Additional definitions are also available in the referenced part of the Rules and Regulations.

Adjusted Trading - Any method or transaction used to defer a loss whereby a federal credit union sells a security to a vendor at a price above its current market price and simultaneously purchases or commits

to purchase from that vendor another security above its current market price.

These investments are highly complex. In order to understand the transactions and activities the reader must understand the following terminology.

Cash Forward Agreement - An agreement to purchase or sell a security, at a future date, with delivery and acceptance being mandatory. The contract for the purchase or sale of a security for which delivery of the security is made in excess of thirty (30) days but not exceeding one hundred-twenty (120) days from the trade date shall be considered to be a cash forward agreement.

Debt security - Any security representing a creditor relationship with an entity. As it applies to federal credit unions, debt securities include such investments as U.S. Treasury securities and Mortgage Backed Securities (MBSs) such as mortgage pass-through securities and Collateralized Mortgage Obligations (CMOs). Debt securities do not include accounts receivable on member loans.

Equity security - Any security representing an ownership interest in an entity or the right to acquire or dispose of such ownership at fixed or determinable prices. An example of an equity security investment is a mutual fund.

Fair value - The current amount at which an investment could be bought, sold, or otherwise exchanged between willing parties, other than in a forced liquidation sale.

Futures Contract - A standardized contract for the future delivery of commodities, including certain government securities, sold on designated commodities exchanges.

Holding gain or loss - The net change in fair value of a security. It does not include earned dividends or interest which have not been received or write-downs resulting from permanent declines in fair value.

Market Price - The last established price at which a security is sold.

Maturity Date - The date on which a security matures. It does not mean the call date or the average life of the security.

Repurchase Transaction - A transaction in which a federal credit union agrees to purchase a security from a vendor and to resell the same or any identical security to the vendor at a later date. See NCUA Rules & Regulations §703.100(i).

Reverse Repurchase Transaction - A transaction whereby a federal credit union agrees to sell a security to a purchaser and to repurchase the same or any identical security from the purchaser at a future date and at a specified price. A reverse repurchase transaction represents a borrowing transaction and is subject to the limitations of Section 107(9) of the Act.

Safekeeping Agreement - A contract whereby a third party of other financial institution, for a fee, agrees to exercise ordinary care in protecting the securities held in safekeeping for its customers.

Settlement Date - The date originally agreed to by a federal credit union and a vendor for settlement of the purchase or sale of a security.

Security - Share, participation, or other interest in property or in an enterprise of the issuer or an obligation of the issuer that (a) either is represented by an instrument issued in bearer or registered form or, if not represented by an instrument, is registered in books maintained to record transfers by or on behalf

of the issuer, (b) is of a type commonly dealt in on securities exchanges or markets or, when represented by an instrument, is commonly recognized in any area in which it is issued or dealt in as a medium for investment, and (c) either is one of a class or series or by its terms is divisible into a class or series of shares, participations, interests, or obligations.

Short Sale - The sale of a security not owned by the seller.

Standby Commitment - An agreement to sell a security on or before a future date at a predetermined price. The seller of the agreement is required to accept delivery of the security (in the case of a commitment to buy) or make delivery of a security (in the case of a commitment to sell) in either case at the option of the buyer of the commitment.

Trade Date - The date the federal credit union originally agreed, whether verbally or in writing, to enter the purchase or sale of a security with a vendor.

Investment types and terms are further defined in Part 703, NCUA Rules and Regulations.

Examples of Transactions Involving Securities

Reverse Repurchase Transaction

A federal credit union may enter into a reverse repurchase transaction, provided no securities purchased with the funds received from the reverse repo, nor any securities collateralizing the reverse repo, have a maturity date later than the settlement date for the reverse repo.

The maximum amount of funds that may be borrowed under a reverse repurchase transaction for investment or deposit purposes is 50 percent of the credit union's paid-in and unimpaired capital.

Since reverse repos represent a borrowing activity, such activity must be approved by the board of directors or a duly appointed executive committee as required by Section 113 of the Federal Credit Union Act. The funds received from the reverse repos should be recorded as borrowed funds in "Notes Payable-Other,". Interest paid on reverse repos should be recorded in "Interest on Borrowed Money,".

Illustrative Entries

In this example, the securities loaned have a carrying amount and fair value of \$1,000. The Cash "collateral" is in the amount of \$1,020. The transferor's return from investing the cash collateral at a 5 percent annual rate was \$5.00. The transferor's rebate to the borrower at a 4 percent annual rate was \$4.00. In addition, assume the loaned securities cannot be redeemed on short notice, for example, by substitution of other collateral. For simplicity, the fair value of the security is assumed not to change during the 35-day term.

*Journal Entries for the Transferor.**At inception:*

- (1) To record the receipt of cash collateral

Dr.- Cash	\$1,020	
Cr.- Payable under securities loan agreements		\$1,020

- (2) To reclassify loaned securities that cannot be redeemed on short notice.

Dr.- Securities loan to broker	\$1,000	
Cr.- AFS		\$1,000

- (3) To record investment of cash collateral.

Dr.- Money Market instrument	\$1,020	
Cr.- Cash		\$1,020

At conclusion:

- (1) To record results of investments.

Dr.- Cash	\$1,025	
Cr.- Interest		5
Cr.- Money market instrument		\$1,020

- (2) To record return of security.

Dr.- AFS	\$1,000	
Cr.- Securities loaned to broker		\$1,000

- (3) To record repayment of cash collateral plus interest.

Dr.- Payable under securities loan agreements	\$1,020	
Dr.- Interest ("rebate")	4	
Cr.- Cash		\$1,024

*Journal Entries for the Transferee.**At inception:*

- (1) To record transfer of cash collateral.

Dr.- Receivable under securities loan agreements	\$1,020	
Cr.- Cash		\$1,020

- (2) To record receipt of borrowed securities that cannot be redeemed on short notice.

Dr.- AFS	\$1,000	
Cr.- Obligation to return borrowed securities		\$1,000

At conclusion:

- (1) To record the return of the securities.

Dr.- Obligation to return borrowed securities	\$1,000	
Cr.- AFS		\$1,000

- (2) To record the receipt of cash collateral and rebate interest.

Dr.- Cash	\$1,024	
Cr.- Receivable under securities loan agreements		\$1,020
Cr.- Interest revenue ("rebate")		4

Securities Lending Transaction

A securities lending transaction is similar to the reverse repurchase transaction described above except that the cash does not go to the transferor. Instead of

receiving the cash, a third party (broker/dealer) invests the funds for the credit union. As a result, a fee income is derived (net of charges from broker/dealer).

OTHER INVESTMENT ACTIVITIES

Part 703, NCUA Rules and Regulations, identifies investments that federal credit unions may invest in. Section 107(7) and 107(8) of the Federal Credit Union Act authorize these securities. Federal credit unions should refer to these sources prior to making investment decisions.

Not all the permissible investments for credit unions are covered in the following sections. A few examples of permissible investments and the recommended accounting treatment are shown.

Deposits in Commercial Banks, S&Ls, Savings Banks

These accounts are used to record investments in shares, deposits and certificates of financial institutions other than credit unions. Sections 107(7) and 107(8) of the Federal Credit Union Act authorize such investments including:

- a) Shares or accounts of savings and loan associations or mutual savings banks insured by the Federal Deposit Insurance Corporation (FDIC);
- b) Deposits in national banks and in state banks, trust companies, and mutual savings banks operating in accordance with the laws of the state in which the federal credit union does business, or in banks or institutions the accounts of which are insured by the FDIC.

Subsidiaries of the General Ledger Accounts

If the credit union has two or more investments in other shares, deposits or certificates, it is recommended that subsidiary records be maintained to clearly identify each investment transaction. If subsidiary records are maintained, it should not be necessary to complete the "Explanatory Remarks" column of the General Ledger account.

Illustrative Entries

- a) When investments are made in shares or deposits, other than with another credit union:

Dr.- Commercial Bank Deposits	\$50,000
OR	
Dr.- Savings & Loan and Mutual Savings Bank Deposits	\$50,000
Cr.- Cash	\$50,000

- b) When investments are withdrawn or redeemed:

Dr.- Cash	\$1,000
Cr.- Other Shares, Deposits and Certificates	\$1,000

- c) When income earned on such deposits are automatically reinvested:

Dr.- Commercial Bank Deposits	\$1,000
OR	
Dr.- Savings & Loan and Mutual Savings Bank Deposits	\$1,000
Cr.- Income from Other Shares, Deposits and Certificates	\$1,000

- d) To record the withdrawal of shares, deposits or certificates:

Dr.- Cash	\$25,000
Cr.- Commercial Bank Deposits	\$25,000
OR	
Cr.- Savings & Loan and Mutual Savings Bank Deposits	\$25,000

Detailed Transactions

Debit:

- a) With deposits and investments in commercial banks, savings & loan associations and mutual savings banks.

b) With income earned on deposits and investments and reinvested in commercial banks, savings & loan associations, or mutual savings banks. (Note: This entry assumes that the income is added to the deposit or investment rather than received by separate check.)

Credit:

a) With withdrawals or redemptions of deposits and investments in commercial banks, savings & loan associations, and mutual savings banks.

Deposits in Corporate Credit Unions

Membership Capital at Corporate Credit Unions

Represents funds invested in a corporate credit union that have a minimum withdrawal notice of three years, are not insured by the NCUSIF or other share or deposit insurers, and cannot be used to pledge against borrowings. These funds are available to a corporate credit union to cover losses that exceed reserves, undivided earnings and paid-in-capital. A credit union may sell its membership capital to another credit union in the corporate credit union's field of membership, subject to the corporate credit union's approval. The funds may be in the form of a term certificate, or may be in the form of an adjusted balance account. An adjusted balance account may be adjusted in relation to a measure (e.g. one percent of a member credit union's assets) established and disclosed by the corporate credit union at the time the account is opened without regard to any minimum withdrawal notice period.

Therefore, these funds are accounted for like other certificates or other adjusted longer-term accounts.

Paid-In Capital at Corporate Credit Unions

Represents funds invested in a corporate credit union with an initial maturity of a least 20 years. This account is not insured by the NCUSIF or other share or deposit insurers.

All Other Investments in Corporate Credit Unions

Represents all other investments at a corporate credit union that did not fall into the category of cash and cash equivalents, membership capital or paid-in capi-

tal. The accounting for these instruments will be similar to the accounting shown for investments in banks and S&L's.

PERMISSIBLE INVESTMENT ACTIVITIES AND TRANSACTIONS SUBJECT TO SPECIFIED CONDITIONS

Pair-Off Transaction

A pair-off is a security purchase transaction that is closed or sold at, or prior to, the settlement date.

Generally, a federal credit union could commit to purchase a security and sometime thereafter commit to sell the security on the same settlement date. The purpose in engaging in pair-off transactions is not to take delivery of the security purchased, but to speculate that the market price will increase before settlement date and a gain will result from its sale.

Many times the commitment to sell is made the same day as the commitment to purchase. There may even be a standing order with the vendor to sell when a certain market price is reached. Pair-off transactions represent a speculative activity which are generally unsafe and unsound. There is strong evidence to show that it has been used as a means of "churning" credit union accounts to generate brokerage commissions. Regardless, any pair off transactions must be accounted for as a "Trading Account".

Mortgage Pass-Through Securities

Mortgage pass-through securities were the first form of mortgage-collateralized securities to be issued. With a pass-through security, investors purchase an undivided interest in an underlying pool of mortgages that serves to collateralize the pass-through security. As the mortgages in the pool are repaid, principal and interest are passed through to each investor on a pro rata basis. All pass-through securities have an issue date; a coupon or pass-through rate; and a final or stated maturity date.

Mortgage originators, such as commercial banks, and S&Ls, etc., are among the most active in pooling mortgages and issuing pass-through securities. The originator usually issues a pass-through with the guarantee of a federally sponsored agency. In addi-

tion, a large volume of mortgages are purchased, pooled and collateralized under agency programs. The agencies that guarantee and issue pass-through securities are the Government National Mortgage Association (Ginnie Mae); the Federal Home Loan Mortgage Corporation (Freddie Mac); and the Federal National Mortgage Association (Fannie Mae).

When a pass-through is not backed by the guarantee of a federally sponsored agency, it falls into the category of "privately issued" and may be backed by pool insurance, letters of credit, and other credit enhancements.

Federal credit unions may invest in pass-through securities issued or guaranteed by the Government National Mortgage Association (GNMA), Federal National Mortgage Association (FNMA), or the Federal Home Loan Mortgage Corporation (Freddie Mac). Under Section 107(15)(B) of the Federal Credit Union Act, federal credit unions may also invest in privately issued pass-through securities as defined in Section 3(a)(41) of the Securities Exchange Act of 1934.

When a credit union acquires a mortgage pass-through security, it must assess its intent and ability with regard to the security and assign it to the appropriate measurement category: *trading*, *held-to-maturity*, or *available-for-sale*. Not less frequently than the end of each dividend period, (i.e., monthly, quarterly, semiannually or annually), the appropriateness of the classifications, and the reasonableness and accuracy of the related measurement (*trading* and *available-for-sale*), shall be assessed.

Illustrative Entries

The IMU FCU purchased \$100,000 worth of pass-through securities for \$99,000. The securities have a 30-year life and have a 10% pass-through paid monthly. The annual effective yield to maturity is 10.12%. The credit union has the ability to hold the investment to maturity and the positive intent to hold it for the foreseeable future.

(Note: This illustration assumes no significant changes in prepayment assumption from the purchase date to maturity, therefore, periodic adjust-

ments to the investment carrying value are not illustrated.)

- a) IMU's entry at the point of purchase.

Dr.- Held-to-Maturity Securities	\$100,000
Cr.- Discount on Held-to-Maturity Securities	\$1,000
Cr.- Cash	99,000

- b) To record the receipt of the first monthly payment: the recognition of income at the effective rate, the accretion of discount (the difference between income at the pass-through rate and income at the effective rate), and the return of principal.

Dr.- Cash	\$877.75
Dr.- Discount on Held-to-Maturity Securities	1.57
Cr.- Income on Federal Agency Securities	\$834.90
Cr.- Held-to-Maturity Securities	44.42

- c) To record the receipt of the second monthly payment: the recognition of income at the effective rate, the accretion of discount (the difference between income at the pass-through rate and income at the effective rate), and the return of principal.

Dr.- Cash	\$877.57
Dr.- Discount on Held-to-Maturity Securities	1.56
Cr.- Income on Federal Agency Securities	\$834.52
Cr.- Held-to-Maturity Securities	44.61

If the credit union holds this investment to maturity, they should receive a full return of principal plus interest.

If there is a significant change in prepayment assumptions on the underlying pool of mortgages, i.e., the underlying mortgages are paying significantly faster or slower than anticipated, the carrying value must be adjusted to reflect the change in prepayment rate.

This adjustment is accomplished by discounting the cash flows received to date, plus the cash flows the credit union anticipates to receive in the future based on the new prepayment assumptions back to the original purchase date to determine the new anticipated yield. The new yield thus calculated is then applied from date of purchase to calculate what the carrying value of the security would be today had the new yield been applied since purchase.

The booked carrying value is then adjusted through current period income to reflect the adjusted carrying value and the amortization is continued at the new effective rate.

Collateralized Mortgage Obligations (CMOs)

A CMO is a multi-class bond issue collateralized by whole mortgage loans or mortgage pass-through securities. The cash flows of the underlying mortgages are used to make the principal and interest payments on the bonds.

The key difference between a conventional mortgage pass-through security, such as a Government National Mortgage Association (Ginnie Mae) pass-through, and a CMO is in the distribution of principal payments. With a conventional pass-through, the interest and principal payments received each month from mortgage holders are passed through to all security holders on a pro rata basis. Because of prepayments, the pass-throughs cash flows tend to be irregular and widely dispersed over time. The security remains outstanding for as long as any of the mortgages in the underlying mortgage pool are outstanding (up to 30 years where the pass-through is backed by long-term mortgages).

The CMO structure substitutes sequential retirement of bonds for the pro rata return of principal found in the pass-through, the result of which is to create mortgage-backed securities with short, intermediate and long-term maturities.

Typically, the first class of CMO bonds receives all principal generated by the issue until it is completely retired; then the second class begins to receive principal until it is retired and so on. Interest is paid on all outstanding bonds unless they are accrual or "Z" bonds.

CMO's have been issued by the Federal Home Loan Mortgage Corporation (Freddie Mac) and the Federal National Mortgage Association (Fannie Mae) and have also been privately issued by securities firms, S&L's, mortgage bankers, home-builders, and life insurance companies. A federal credit union may invest in CMO's issued by Freddie Mac or Fannie Mae and privately-issued CMO's as defined by Section 3(a)(41) of the Securities Exchange Act of 1934.

Illustrative Entries

Suppose a credit union invested \$92,128.55 in the second tranche of a CMO valued at \$100,000. The credit union has the intent and ability to hold the investment to maturity. The estimated life of the second tranche of the CMO is 6 years with receipt of interest only for 3 years while the first tranche receives principal and interest payments and receipt of principal and interest payments for the next three years. The pass-through rate of interest is stated as 7% and the annual effective yield to maturity is expected to be 9.1936%.

(Note: This illustration assumes no significant changes in prepayment assumption from the purchase date to maturity, therefore, periodic adjustments to the investment carrying value are not illustrated.)

- a) The credit union's entry at the point of purchase.

Dr.-Held-to-Maturity Securities	\$100,000
Cr.- Discount on Held-to-Maturity Securities	\$7,871.45
Cr.- Cash	92,128.55

- b) To record the receipt of the first monthly payment: the recognition of income at the effective rate, the accretion of discount (the difference between income at the pass-through rate and income at the effective rate) and the receipt of income at the pass-through rate while the first tranche is receiving a payment of principal plus interest.

Dr.- Cash	\$583.33
Dr.- Discount on Held-to-Maturity Securities	122.50
Cr.- Income on Federal Agency Securities	\$705.83

c) To record the receipt of the second monthly payment: the recognition of income at the effective rate, the accretion of discount (the difference between income at the pass-through rate and income at the effective rate) and the receipt of income at the pass-through rate while the first tranche is receiving a payment of principal plus interest.

Dr.- Cash	\$583.33
Dr.- Discount on Held-to-Maturity Securities	123.43
Cr.- Income on Federal Agency Securities	\$706.76

At the end of three years when the first tranche is fully satisfied, the second tranche will become a pass-through security and the accretion of discount using the interest method will proceed as demonstrated in the previous section to pass-through securities. Remember, when there is a significant change in prepayment assumptions (rates) the carrying value of the security must be adjusted through current period income.

Investment in the Central Liquidity Facility (CLF)

See the specialized section for specifics on this investment.

Zero Coupon Securities

A zero coupon security is a security that makes no periodic interest payments, but instead is sold at a deep discount to its face (par) value. The buyer of such a security realizes the rate of return by the gradual appreciation of the security, receiving the face value of the security as a lump sum payment on a specified maturity date.

Because zero coupon securities bear no interest, they are among the most volatile of all fixed income securities. Since holders of zero coupon securities do not receive interest payments, these securities fall more

dramatically than bonds paying interest on a current basis when interest rates rise.

On the other hand, when interest rates fall, zero coupon securities rise more rapidly in value because the bonds have locked in a particular rate of reinvestment that becomes more and more attractive as rates fall further. The greater the number of years a zero coupon bond has until maturity, the less the investor has to pay for it and the more leverage the investor has at work for him.

For instance, a bond that matures in 5 years may double in value while a bond that matures in 25 years may increase in value 10 times, depending on the interest rate of the bond.

To be a permissible investment, the zero coupon security must have a maturity date that is 10 years or less from the settlement date.

Illustrative Entries

Assume a credit union purchased a \$1,500,000 zero coupon bond for \$534,000 expecting an effective yield of 10.6% to maturity in 10 years. Assume also that the credit union has the intent and ability to hold the zero to maturity.

a) The credit union's entry at the point of purchase.

Dr.-Held-to-Maturity Securities	\$1,500,000
Cr.- Discount on Held-to-Maturity Securities	\$966,000
Cr.- Cash	534,000

b) To record the receipt of the first semiannual accretion of discount:

Dr.-Discount on Held-to-Maturity Securities	\$28,302
Cr.- Income on U.S. Gov't Obligations	\$28,302

c) To record the receipt of the second semiannual accretion of discount:

Dr.-Discount on Held-to-Maturity Securities	\$29,802
Cr.- Income on U.S. Gov't Obligations	\$29,802

Notice that after the first year, the carrying value of the zero coupon bond has grown from \$534,000 to \$592,104.

Accounting for Mutual Funds

When a credit union invests in a mutual fund, it purchases a number of shares (units) in the fund generally paying a broker's commission or load fee as part of the purchase price. The fund invests the proceeds from the sale of shares in a portfolio of securities to be held and /or traded for profit.

The broker's fee or commission is passed on to the broker securing the sale. Each mutual fund investors' share/unit in the mutual fund is worth an amount calculated based on the total market value of the number of outstanding units in the fund. This value per share is known as the net asset value per share. (NAV).

The NAV of a share/unit in the fund fluctuates periodically based on the changing market value of the underlying ties in the mutual fund portfolio, as well as the natural change in the value of the portfolio, inherent in continually buying and selling securities.

Generally, as interest rates fall, the value of the underlying securities in the mutual fund portfolio rises and, likewise, the NAV per share increases; conversely as interest rates rise, the value of the underlying securities in the mutual fund portfolio decreases and, likewise, the NAV per share drops. Thus, the credit union investor's NAV per share drops. The credit union's NAV per share is dynamic, rising and falling with interest rates and the changing securities market.

Generally accepted accounting principles (GAAP) provide that certain equity securities (like mutual funds) should be accounted for as trading or available-for-sale at fair value. Fair value for trading accounts is booked through income; fair value for available-for-sale securities is debited/credited through a separate component of equity (other com-

prehensive income) in the statement of financial condition.

Illustrative Entries:

Assume a credit union purchased shares/units in three different mutual funds as follows:

1/13/01 Fund A - 10,000 shares @ \$10.00 per share
 2/05/01 Fund B - 10,000 shares @ \$8.00 per share
 3/20/01 Fund C - 4,000 shares @ \$16.00 per share

The accounting entries made on the credit union's books at the time of purchase are detailed below. The broker's commission (load fee) is included in the quoted share/unit purchase price.

Dr.-Available-for-Sale Securities	\$245,000
Cr.- Cash	\$245,000

To continue the example, at the quarter ending 3/31/01 when the credit union is closing its books but prior to paying dividends to its members, the credit union needs to adjust the mutual fund investments to the fair value. Assume that the 3/31/01 market values of the three funds are as shown in the table below:

Mutual Fund	Original Cost	Current Fair Value	Gain or (Loss)
A	\$100,000	\$ 95,000	(\$5,000)
B	80,000	80,000	
C	65,000	62,000	(3,000)
	<u>\$245,000</u>	<u>\$237,000</u>	<u>(\$8,000)</u>
	(A)	(B)	(B-A)

Although, the funds were purchased during the quarter for a total of \$245,000, the fair value of the funds in aggregate at 3/31/01 has declined to \$237,000. Therefore, the credit union should adjust the carrying value of its mutual fund investments downward to the current fair value.

Dr.- Accumulated Unrealized Gains/Losses on Avail- able-for-Sale Securities	\$8,000
Cr.- Available-for-Sale Securi- ties	\$8,000

(Accumulated Unrealized Gains/Losses on Available-for-Sale Securities is part of Other Comprehensive Income and must be netted with Undivided Earnings before the credit union declares dividends.)

Assume during the second quarter, the mutual funds in aggregate increase in value. Assume that at the end of the second quarter, 6/30/01, when the credit union closes their books and before paying dividends, the mutual funds are valued as follows:

Mutual Fund	Current Balance Sheet Value	Current Market Value	Gain or (Loss)
A	\$ 95,000	\$104,000	
B	80,000	82,000	
C	62,000	62,000	
	<u>\$237,000</u>	<u>\$248,000</u>	<u>\$11,000</u>
	(B)	(C)	(C-B)

In this case the entry would be:

Dr.- Available-for-Sale Securities	\$11,000
Cr.- Accumulated Unrealized Gains/Losses on Avail- able-for-Sale Securities	\$11,000

Accounting for Unit Investment Trusts

A unit investment trust is an investment vehicle that purchases a fixed portfolio of income-producing securities, such as Treasury bonds or mortgage-backed securities. Units of the trust, which usually cost at least \$1,000, are sold to investors by broker/dealers for a sales charge which may range up to 5% of the total dollar amount of the purchase.

With a unit investment trust, investors own an undivided interest in the principal and interest portions of the portfolio in proportion to the amount of money

they invest. Usually, the portfolio of securities remains fixed until all the securities mature and unit holders have recovered their principal. Most broker/dealers maintain a secondary market in the units they sell, so that the units can be resold if necessary.

Unlike mutual funds, the underlying portfolio remains fixed until all of the securities have matured. However, similar to mutual funds, a credit union cannot control the securities placed into the trust by the underwriter or the disposal of individual portfolio issues. NCUA has found in predominate practice that unit investment trusts are most often classified outside the definition of a "security" (because they do not have a determinable fair value nor are they "exchanged") and thus, are carried at amortized cost.

Put Options

Increased real estate lending by federal credit unions has led to increased risks related to the interest rate sensitivity of such loans and their longer terms. Under Part 701.21(i) of the NCUA Rules and Regulations, a federal credit union may purchase long put options on Government National Mortgage Association (GNMA), Federal National Mortgage Association (FNMA), and Federal Home Loan Mortgage Corporation (FHLMC) securities in order to manage interest rate risk for real estate loans produced for sale on the secondary mortgage market.

When purchasing a put option, a federal credit union acquires the right to sell a certain security at a specified price within a particular period of time. There are two parties to the put option agreement:

- The "holder" (the Credit Union) who, in exchange for paying an upfront fee, acquires the right to sell the security in accordance with the option contract.
- The "writer" (another party) who, in exchange for receiving an upfront fee, must stand ready to purchase the security on demand by the holder, in accordance with the terms of the option contract.

Because the market value of a put option on a GNMA, FNMA, or FHLMC security may be expected to rise with an increase in market interest rates, such an option is considered "term insurance" against an increase in market interest rates from the

time the rate is committed to the member during loan application to the time the loan is sold on the secondary market.

Under the regulation, a federal credit union may purchase put options if:

- a) The related loans are to be sold on the secondary mortgage market within 90 days of closing;
- b) The positions are entered into through a contract market designated by the Commodity Futures Trading Commission or with a primary dealer in government securities;
- c) The positions are entered into through written policies that meet the minimum requirements contained in the regulation;
- d) The credit union has received permission from the appropriate Regional Director to engage in options transactions;
- e) Reports must be submitted monthly to the Regional office unless waived by the NCUA Regional Director;
- f) Records must be retained for two years; and
- g) The transactions are accounted for in accordance with standards established under GAAP to the extent not inconsistent with NCUA Board instructions.

UNAUTHORIZED INVESTMENT TRANSACTIONS AND ACTIVITIES

Because of the inherent risk involved in certain investment transactions and activities a federal credit union may not:

- 1) Enter into a standby commitment to purchase or sell a security,
- 2) Buy or sell a futures contract,
- 3) Engage in adjusted trading or a short sale, or
- 4) Enter into a yield maintenance contract.

Adjusted Trading

The most common form of adjusted trading occurs when a credit union cannot meet its commitment to purchase a security on the settlement date, and the market price is below the commitment price. Thus, if the credit union is forced to immediately sell the security it will incur a loss.

To prevent the loss, the credit union would enter into an agreement to resell the security to the broker at the commitment price and to enter into another commitment to purchase a different security at a price that exceeds its market value. Thus, the credit union has deferred its loss in hopes that the market price of the security underlying the new commitment will increase by the new settlement date.

A less common form of adjusted trading occurs when a credit union swaps or exchanges a lower yielding security for a higher yielding security. In this case, the sale of the low yielding security would result in a loss, which the credit union does not wish to recognize during the current accounting period. Again, the credit union agrees to sell its security and buy the new security at prices above market. Another name for these transactions is overtrading.

A variation of the adjusted trade involving a forward commitment is known as "fee trading" or "reposition trading." This transaction is the same as the first example above except that the broker is unwilling to take the risk of purchasing the initial security. The credit union would sell at a price above market. Therefore, the broker requires that the credit union pay a fee, which is the difference in the commitment price and the market price when they enter into the transactions. When the credit union purchases the new security, the broker returns the fee. Often, this type of transaction occurs repeatedly. The fee is usually recorded by the credit union as a receivable, deferred charge, or other asset.

The above described transactions, under whatever name, constitute adjusted trading and, thus, are prohibited.

Yield Maintenance Contract

A yield maintenance contract, also known as a "pair-off" hedger, is the concurrent commitment to pur-

chase a security via a cash forward agreement and to sell the same security on the same settlement date via a standby commitment. The credit union would be required to pay a generally exorbitant commitment fee to the vendor. The purpose of the transaction would be to "guarantee" a specified yield which is based upon the commitment fee paid. Generally, the purchase and sale prices are not related to the current market price.

Yield maintenance contracts are not permitted since they violate Section 703.110 of the National Credit Union Administration Rules and Regulations. The yield maintenance contract is an unsecured loan to a broker (a nonmember) and thus is in violation of Section 107(5) of the Federal Credit Union Act.

Stripped Mortgage-Backed Securities (IO's/PO's)

Stripped Mortgage-Backed Securities (SMBS's) consist of two classes of securities with each class receiving a different portion of the monthly interest and principal cash flow of the underlying mortgage backed securities. In its purest form, an SMBS is converted into an interest-only (IO) strip, where the investor receives 100% of the interest cash flow and a principal-only (PO) where the investor receives 100% of the principal cash flow.

All IO's and PO's have highly volatile price characteristics based on changes in the prepayment pattern of the underlying mortgages and consequently on the maturity of the stripped security. Generally, IO's will increase in value when interest rates rise. Accordingly, the purchase of an IO strip may serve to offset the interest rate risk associated with mortgages and similar instruments held by a federal credit union.

Similarly, a PO may be useful as an offset to the effect of interest rate movements on the value of mortgage servicing. However, when purchasing an IO or PO, the investor is speculating on the movements of future interest rates and how these movements will effect the prepayment pattern of the underlying mortgage collateral. Further, those SMBS's that do not have the guarantee of a federally sponsored agency (privately-issued SMBS'S) as to the payment of mortgage principal and interest have an added element of credit risk.

SMBS's have been issued by the Federal National Mortgage Association (Fannie Mae) and have also been "privately-issued" to a limited degree. NCUA has determined that SMBS's are not suitable investments for federal credit unions and therefore are impermissible investments per 703 of the NCUA Rules and Regulations.

Zero Coupon Securities

A Federal Credit Union may not purchase a zero coupon investment with a maturity date that is more than 10 years from the settlement date.

OTHER INVESTMENT CONSIDERATIONS

Investment Trading Policies

The board of directors of a federal credit union that intends to engage in securities trading should develop and adopt a written trading account policy that includes, at a minimum, the following provisions:

- a) Individuals who have purchase and sale authority;
- b) Trading account size limitations;
- c) Allocation of credit union's cash flow to trading accounts;
- d) Stop-loss or sale provisions;
- e) Dollar-size limitations of specific types, quantities and maturities to be purchased;
- f) Monthly market price adjustments;
- g) Limits on the length of time an investment may be inventoried in the trading account;
- h) Monthly reports to the Board of all purchase and sale transactions and the resulting gain or loss to be reported on an individual basis. Purchases and sales shall be reported at trade date;
- i) A prohibition against the use of a broker/ securities dealer in purchase or sales transactions unless, prior thereto, the credit union has in its files evidence

of the broker/dealer's financial responsibility and capability, and management has made reasonable inquiries concerning the broker/ dealer's reputation;

j) A requirement that any security purchased for trading purposes will be recorded at market value on the trade date; and

k) Requirements with respect to securities transfers between the credit union's investment and trading accounts:

1) The securities being transferred shall be revalued to the current fair value;

2) Any adjustment in connection with transfer of a security shall be accounted for consistent with GAAP.

3) No transfers shall be made between categories unless transfer of the security is consistent with previously established investment portfolio policies and objectives. Such transfers are unusual and should be rare.

Responsibility

The board of directors is responsible for the investment of credit union funds in accordance with Section 113 of the Federal Credit Union Act (Act). In general, these investments are limited to those authorized by Section 107(7), 107(8) and 107(15) of the Act. Additionally, Part 703 of the National Credit Union Administration Rules and Regulations and various NCUA Interpretive Ruling and Policy Statements impose additional limitations and/or requirements.

The board of directors must establish policies and procedures to ensure that the credit union's overall financial objectives are being met and that the investment program will provide adequate liquidity, safety and yield to the credit union. To achieve these goals, the board will need to give attention to the following investment considerations:

A federal credit union's ability or inability to make a quick decision to purchase or sell an investment could result in a gain or loss of thousands of dollars. By the same token, a quick decision to invest in a security or enter into a transaction that management

does not understand could result not only in potential losses, but also long-term liquidity problems. Additional information and guidance relative to sound practices for managing the risks of investment activities is contained in NCUA Interpretive Ruling and Policy Statement No. 98-2; *Supervisory Policy Statement on Investment Securities and End-User Derivatives Activities*.

A sound investment policy facilitates purchases and sales of securities while assuring their safety. Each security, investment and type of transaction should be analyzed, approved by the board of directors and formally addressed in the investment policy manual. The investment policy should consider the following:

a) U.S. Government and federal agency securities vary in guarantee, yield, interest rates and maturities. Some may not meet the overall needs and objectives of the credit union. The investment policy should list disapproved, as well as approved investments. Any new issue should be presented to the board with an appropriate prospectus and background information before decisions are made.

b) Shares, deposits, or investments in savings and loan associations, banks and credit unions may present a risk not generally recognized, especially when investments exceed insured limits. A thorough review of these institutions' financial statements before investment should disclose any undue risk, and periodic review after the investment should be required. The manual should also specify any limitation or restriction of these investments.

c) All other investments should be reviewed on an individual basis and cited in the investment policy. A sound investment policy addresses the need to facilitate purchases and sales of securities and to enter into safe investment transactions. In many credit unions, this means delegating the responsibility for individual approvals to either an executive or investment committee. This should be done carefully. The right to delegate is not the right to abdicate. Clear written guidelines outlining the delegated authority will ensure that the board's policies are carried out.

In some cases, an individual may be authorized to invest or divest funds in specific investments on a continuing basis, such as in a common trust when-

ever the checking account balance is in excess of a specified balance. Additionally, an individual may be assigned to advise a broker of the board's decision to purchase an investment or to sign documents. Investment policy should make clear that these responsibilities are not a "carte blanche" authorization to invest credit union funds.

The type of funds management employed by a credit union depends upon its size, resources, volume of activity, and management expertise. Generally, the more detailed the concept, the better control the credit union has over its ability to meet member needs.

Special Considerations

There are certain factors which must be considered when integrating investment policy into overall goals and objectives. These factors are safety, liquidity, and yield.

Safety

Despite being limited by law to investments that are primarily guaranteed as to principal and interest, certain investment risks do exist for Federal credit unions. These risks include:

- a) *Market risk* - a possible reduction in value resulting from changes in market demand.
- b) *Interest rate or maturity risk* - a possible reduction in value resulting from increases in interest rates.
- c) *Credit risk* - a possible loss if the issuer of an investment defaults. (This could result from imprudent investments in savings and loan associations and banks in excess of insured limits, or investments in credit unions.)
- d) *Price-level risk* - a possible reduction in purchasing power of the dollar as a result of inflation.

Federal credit unions can reduce investment risks by fully evaluating each type of investment prior to purchase, including the issuer, analyzing the financial condition and reputation of any intermediary to the transaction, such as a broker/dealer; and diversifying

the investment portfolio by type, maturity, geographical location, guarantor, etc.

Liquidity

Investment policy must be flexible enough to allow for changes in the balance sheet items that represent member needs, i.e., shares and loans. As such, investment practices can be considered a function of share and loan behavior. Each time there is a shift in either share or loan volume, there may exist a need to shift investment strategy.

Suppose, for example, the board of directors decides to expand loan policies by offering longer term loans to meet member needs. This will result in a slower turnover of funds, and thus will expand the loan portfolio. If share deposits cannot be expected to meet the increased loan demand, investment policies must reflect a change. In this case, the credit union would probably shorten investment maturities to meet the expected loan demand.

Another factor which would affect Liquidity is the movement and direction of interest rates. As they increase, the value of long-term securities decreases. Thus a credit union with long-term securities during a period of increasing interest rates would become illiquid unless the loss incurred through their sale could be absorbed.

Yield

Only after liquidity and safety are considered should investment analysis center on yield. As a general rule, investments with higher risk factors and greater price volatility command the greater yield. Thus the potential for greater income must be weighed very carefully against the risks of reduced liquidity and/or potential losses.

Authorized Broker/Dealers

The credit union's investment policies should identify all institutions and dealers/brokers with whom the board of directors and/or investment committee/officer are authorized to transact investments. Approval of institutions and dealers/ brokers should be preceded by a thorough analysis of their financial stability, services provided, responsiveness, and reputation. The credit union should formalize its

relationship with investment institutions and specifically identify which credit union officials are authorized to transact credit union investments. Contractual arrangements with investment institutions should be reviewed at least annually.

Reporting Requirements

The investment policy should specifically state the types of reports required by the board to make investment decisions. These reports may include a summary of investments by type, maturity, size, market values or concentration. Additionally, executive and/or investment committees should prepare a monthly list of all investments which they authorized and any significant occurrences during that period.

Internal Controls

The investment policy should require that adequate internal controls are established to separate the responsibilities for approving, disbursing, reconciling and accounting for investment activities. A flow chart depicting these responsibilities may be needed.

Surety Aspects

The investment policy should give consideration to the maximum amount of coverage and other possible limitations contained in the surety bond. However, the board should not rely on the expectation of surety coverage as a substitute for sound and prudent investment policies.

Safekeeping

The board should establish investment policies which will protect securities held in safekeeping. The policies require that:

- a) All securities not in the physical possession of the credit union should be held in a third party (a bank or other financial institution) safekeeping account. A separate trust division of a bank acting as a dealer qualifies as a third party safekeeping institution.
- b) In establishing a safekeeping account, cost and service should be considered. The broker's bank may be used for safekeeping services. However, safekeeping agreements should provide that all transactions will be ordered only by a duly author-

ized employee or official of the credit union. If the safekeeping institution is to be used to transmit credit union funds for purchases of securities, the agreement should provide that the funds will not be transferred until the securities are received by the institution.

Safekeeping services should be covered by a "safekeeping agreement". Under this arrangement, the institution, for a fee, agrees to exercise ordinary care in protecting the securities held in safekeeping. Unless specifically covered by statute or contract, the institution is not an insurer of the securities. It is liable only for negligence in caring for and protecting the securities.

Periodic Review Policy

The investment policy should be reviewed by the board of directors at least annually. This should ensure that policies and procedures are kept current and that the officials remain in control of the investment program.

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LOANS HELD FOR SALE

This account represents loans held-for-sale which must be classified separately from other loans. Mortgage loans held for sale are reported on the financial statements at the lower of cost or market value. Mortgage-backed securities are reported and classified as securities (See Investment section). However, a credit union must classify as trading any retained mortgage-backed securities that it commits to sell before or during the securitization process. Loan origination fees and related direct loan origination costs for loans held for sale shall be capitalized as part of the carrying amount of the related loan and shall not be amortized.

Credit unions should be aware there are special generally accepted accounting principles with regard to acquiring mortgage servicing rights (MSR) and servicing of mortgage loans. A full discussion of MSR is beyond the scope of this Manual.

LOANS RECEIVABLE

This account represents the total amount outstanding in loans receivable from members and is a summarization of all the individual loan ledgers for that particular type of loan. Totals of the balances of the individual loan ledgers must be taken at the end of each month to insure that they are in balance with this General Ledger control account. Particular attention should be given to the discussion and requirements of the NCUA Rules and Regulations.

Loan origination fees and related direct loan origination costs for loans held for investment shall be deferred and recognized as an adjustment to yield. Loan commitment fees shall be deferred and recognized over the life of the loan or until the loan is sold, while fees paid to permanent investors shall be recognized as expense when loans are sold. Fees for services performed by third parties and loan placement fees are recognized as revenue when all significant services have been performed.

LOANS RECEIVABLE BY TYPE**Consumer Loans**

This account includes loans made to members for consumer type expenditures such as automobiles, trucks, motorcycles, recreational vehicles, household goods, home improvements, revolving credit, medical expenses, vacations, taxes and similar items. Revolving credit loans would also be included in this account. Many credit unions, through use of their computer systems, are able to keep records on the various types or purposes of loans to reflect the number and balances outstanding in each category for comparison purposes. The credit union needs to keep detailed subsidiary records of individual loans granted and/or outstanding by loan types. The subsidiary records should be subtotaled, the total of the balances should be proved with the balances in this account at least monthly, and the listings retained in the files.

Business (Commercial) Loans

Commercial or business loans are generally defined as having the following characteristics: (1) repayment will be made from business revenue, (2) the security is a business asset, (3) the purpose is to obtain a business or business asset, or (4) the proceeds will be used to finance a business operation. Specific requirements have been established in the NCUA Rules and Regulations. A federal credit union may make business loans only in accordance with all the provisions of the regulations. The credit union staff must have the expertise required to protect against losses which could result. Since most business loans are larger, the risk of losses is much greater. With this type of loan, the emphasis on underwriting such loans shifts from the individuals, as in a regular consumer loan, to the financial soundness of the business requesting the loan.

The loan should be supported by commercial credit reports, analysis of income and expense statements, cash flow and balance sheet analysis. Cash flow is often a problem for most small businesses. Considering the high percentage of new business that fail, additional collateral should be considered in financing a new business by the credit union. If inventory is taken as collateral, it should be recognized that upon forced sale, the value of that inventory may

only be a fraction of the value of this finished product.

Agriculture Loans

The same specific requirements for business loans contained in the NCUA Rules and Regulations are required for agriculture loans. A credit union making agricultural loans must take into account various factors that may not be present in considering urban real estate as security on loans. Loans are made not on the acreage alone, but upon the productivity of those acres. Erosion and wastage as well as fertility must be studied since the loan may be repaid over a long period of time. Productivity of the farm over a series of years as a source of repayment must be considered since it must first provide a living for its owners. The lender must be sure there will be funds to pay taxes and operating expenses, including reasonable allowances to maintain the productivity of the land, and still leave a balance to amortize the loan. The applicant must be able to demonstrate managerial efficiency.

Accounting records are needed to supply information on the ability of the borrower to repay. Net worth should be used in determining borrowing capacity, but only cash can repay the debt. Income statements are more useful in measuring debt repayment capacity. Tax returns are also essential to determine information on the potential borrower. If crop loans are made, inspections of the growing crops are essential as well as monitoring of disbursements to assure that the proceeds are channeled into the farmer's operation. Livestock loans need inspections at the inception of credit as well as periodically throughout the life of the loan, and the inspections should be documented in the loan files. For example, a loan for a dairy herd purchase would need a detailed written inspection periodically to determine if the cattle are healthy and productive at all times. The inspection would determine if the value of the cattle is adequate to repay the outstanding loan based on market conditions. Likewise, a loan to finance a calf feeder operation would also need periodic inspections to determine that all the livestock purchased were healthy and increasing in value to repay the loan at maturity. These inspections will take expertise which may or might not be readily available in the individual credit union.

Other Member Loans

This account contains various loans to members which do not fit other groupings listed. Included in this account may be investment loans, student loans, and other loans as needed.

Home Equity Loans

A loan gaining wide acceptance in credit unions is the Home Equity loan. These loans may offer a tax benefit to members who itemize deductions for tax purposes. This type of loan plan allows the borrower to use the portion of equity in his/her residence to increase borrowing capacity. These loans can either be first or second mortgage loans.

Although credit unions should employ the same procedures and evaluation of creditworthiness and collateral as in other real estate lending, home equity loans are often different since they may be open-end loans. Advances can be generated in a variety of ways as in any open-end plan.

Credit unions need to develop extensive policies when engaging in home equity lending and should have similar procedures as with traditional real estate loans. A policy on the maximum percentage of appraised value that will be loaned (including unpaid value of the first mortgage plus the maximum loan limit on the second mortgage), proper and accurate written appraisals of the collateral, and detailed evaluation of the applicant's ability to repay are all needed. The loan must comply with provisions contained in Section 701.21 of the NCUA Rules and Regulations as well as other legal requirements where the credit union is located. It is extremely important that legal counsel be consulted so that any problems detected in the loan documents can be alleviated. An attorney's opinion should be on file stating the forms meet all applicable federal, state, and local requirements. Even with the opinion letter from the vendor's attorney, it would be wise to obtain an independent attorney's opinion from an individual who specializes in state law.

Advantages of these types of loans are that the loans are often granted at variable interest rates and are secured by collateral that can often appreciate rather than depreciate. Also, they can be made with relative ease of disbursement after all initial documents

have been prepared and can be modified depending on external factors such as the loan demand.

Disadvantages include the fact that real estate market values may decrease in value, or the property value may decline due to poor maintenance. Also, if this type of lending is not controlled, it could have the impact of overextending the borrower to possible bankruptcy. This type of loan also contributes to a lower loan turnover rate and must be managed from a liquidity and funds management standpoint.

Entries In Journal And Cash Record

The accounting for all types of loans in this series of accounts is basically the same. Debit these accounts in the "Loans-Loaned" column of the Journal and Cash Record with the full amount of new or refinanced loans made to each member. Credit these accounts in the "Loans-Repaid" column with the total of cash payments of principal made by borrowers and endorsers, the balance of old loans included in new or refinanced loans, the application of shares to loans, and the charge-off of uncollectible loans.

Entries canceling loan principal payments because of dishonored checks should be recorded in the "Loans-Repaid" column as deductions by entering the amounts involved in red figures or parentheses.

Posting To General Ledger

Debits and credits to these accounts in the General Ledger are made at the end of each month by posting the totals of the "Loans" columns from the Journal and Cash Record.

Posting To Members' Accounts

The items which are accumulated in the "Loans Loaned" column of the Journal and Cash Record for monthly postings to the General Ledger Loan accounts are also recorded in the Individual Share and Loan Ledger and in the Member's Passbook or Statement of Account. Credit entries for payments made on the loans are posted in these records from the Cash Received Vouchers or equivalents; other credit entries are posted from the "Loans-Repaid" column of the Journal and Cash Record.

Entries showing the charge-off of a loss loan should be identified as such in the member's account in the Individual Share and Loan Ledger. Recoveries on loans charged-off should be recorded as memorandum information on the member's account, or on a work sheet.

The total of the individual loan accounts as shown in the Individual Share and Loan Ledgers needs to be proved with the total of the loans in the General Ledger at least monthly and the listing (adding machine or computerized trial balance) retained in the files.

Illustrative Entries

- a) When a loan is made to a member:

Dr. - Loans	\$100.00	
Cr. - Cash		\$100.00

- b) When an installment on a loan is paid and interest and late charges are collected:

Dr. - Cash	\$11.20	
Cr. - Loans		\$10.00
Cr. - Interest on Loans		1.00
Cr. - Fees and Charges		.20

- c) When a member having a note outstanding with an unpaid balance of \$10.00 gives a new note for \$50.00 and receives a check for \$40.00 and his old note:

Dr. - Loans	\$50.00	
Cr. - Cash		\$40.00
Cr. - Loans		10.00

Note: If a Journal Voucher is used, the new loan should be entered as a debit for the gross amount, the old loan balance as a credit item, and the voucher should indicate the net cash paid in the space opposite "Amount" in the lower left side of the form.

- d) When a member authorizes the credit union to apply his shares to his indebtedness:

Dr. - Shares	\$50.00	
Cr. - Loans		\$49.00
Cr. - Interest on Loans		1.00

- e) The board of directors determines the loan to the member may be a potential loss due to announced bankruptcy proceedings. The Allowance for Loan Losses Account is increased to provide for full and fair disclosure requirements of Section 702.3 of the NCUA Rules and Regulations.

Dr. - Provisions for		
Loan Losses	\$25.00	
Cr. - Allowance for Loan		
Losses		\$25.00

- f) When the board of directors determines that further collection cannot be effected on a loan and authorizes charging off the loan:

Dr. - Allowance for		
Loan Losses	\$25.00	
Cr. - Loans		\$25.00

Note: Only the unpaid principal should be charged-off. If the member has any shares, the shares should be applied to the loan before the charge-off, provided the credit union has obtained the proper statutory liens in court.

Detailed Transactions

Debit:

- a) With total principal amount of new and refinanced loans made to members.

Credit:

- a) With cash payments of principal made by borrowers and endorsers.
- b) With unpaid principal balances of loans included in new and refinanced loans.
- c) With amounts of shares applied to principal of loans.

d) With the unpaid balance of loans transferred to "Loans-Collateral in Process of Liquidation".

e) With the charge-off of loss loans.

LOANS-COLLATERAL IN PROCESS OF LIQUIDATION

The account reflects the total unpaid principal balances of all loans for which the credit union has taken possession of collateral, by legal process or otherwise, and for which the obligation of the borrower has not been canceled. Transfer of the unpaid balance of the particular loans secured by the acquired collateral should be made to this account. If the borrower has other loans outstanding, notations should be made on all his ledger cards to indicate the transfer to this account, but loans of the borrowers not related to the acquired collateral should remain in "Loans".

The purpose of the transfer to this account is to segregate the loan balances for control and accountability and to permit realistic financial analysis of these loans. This account may include costs incurred in acquisition or disposal of collateral related to loans in this account if the loan instrument or other written agreement allows the credit union to add such costs to the borrower's loan balance.

When the borrower's obligation to the credit union has been canceled, by legal requirement in some jurisdictions or by some action of the board of directors, the assets in possession of the credit union should be accounted for in "Assets Acquired in Liquidation of Loans."

Illustrative Entries

a) To record the transfer of the unpaid principal balance of loans for which assets have been acquired by the credit union:

Dr. - Loans - Collateral in Process of Liquidation	\$350.00
Cr. - Loans	\$350.00

b) When the borrower's obligation to the credit union is canceled, to transfer the value of the fair value

of the collateral asset to Assets Acquired in Liquidation of Loans:

Dr. - Assets Acquired in Liquidation of Loans	\$300.00
Cr. - Loans - Collateral in Proc- ess of Liquidation	\$300.00

c) The \$50.00 remaining in Loans- Collateral in Process of Liquidation may be charged-off to Allowance for Loan Losses at this time with authorization of the board of directors. If the board of directors had not previously established the \$50 in the Allowance for Loan Losses Account, it should be authorized at the time of the charge-off of the designated loss amount.

Dr. - Allowance for Loan Losses	\$50.00
Cr. - Loans - Collateral in Proc- ess of Liquidation	\$50.00

Detailed Transactions

Debit:

- a) With the principal balance of loans secured by collateral acquired by the credit union.
- b) With costs incurred in acquisition or disposal of collateral when such costs are legally proper for charge to the borrower's loan balance.

Credit:

- a) With cash payments of principal made by borrowers or endorsers.
- b) With the amounts of shares applied to principal balances.
- c) With the unpaid balances of such loans when the value of the collateral is recorded in "Assets Acquired in Liquidation of Loans".
- d) With charge-offs of loss loans.

PASSBOOKS

For those (few) credit unions still using passbooks, members should be encouraged to present the passbooks for each transaction. If a transaction is not entered in the member's passbook because the passbook is temporarily not available, a temporary passbook or cash received voucher/receipt should be provided. The member should be instructed to present his passbook for entry as soon as practicable. If the passbook is lost, a duplicate should be issued after the member has provided adequate identification.

Entering Member Loans on the Records

For each loan made to members a Journal Voucher should be prepared showing the name of the credit union, the member's account number, the date the check is issued, and the name of the borrower. The amount of the loan is shown in the debit column opposite "Loans" and the amount of the check is entered in the credit column opposite "Cash". The notation "credit committee" or "c/c", or the name of the loan officer, is written in the spaces provided. When the check is delivered to the borrower he/she should, if practical, sign the voucher at the bottom opposite "Received By."

The loan should also be entered in the member's passbook or statement of account. Under the "Loans" section of the passbook, the date of the loan, the amount loaned, and the balance are written and initialed by the authorized credit union official who made the entry. The passbook is then returned to the member with the check.

The loan should be entered in the Journal and Cash Record. The date, borrower's account number, borrower's name, note number, and check number should be entered in the appropriate columns. The amount of cash shown on the check should be entered in the credit column under "Cash-Paid Out." A similar amount should be entered in the debit column under "Loans." If it is a refinanced loan, the amount entered in the debit column should be the amount shown on the check plus the unpaid balance of the loan being refinanced.

Each disbursement for a loan should be posted individually from the Journal and Cash Record or a Journal Voucher to the Individual Loan Ledger of the

the member. A loan made is entered on a line opposite the date, which has been written in the "Date" column headed "Amount Loaned." The same amount is carried over and entered in the "Balance" column. The note number is entered in the column headed "Note No." Under the column headed "Post Ref" is written the page in the Journal and Cash Record from which the entry is posted, such as "JC 1." When the item is posted, a checkmark should be placed in the checkmark column () of the Journal and Cash Record or in the space opposite "Posted" on the Journal Voucher.

The "Cosigner on Notes of Others" section of the Individual Share and Loan Ledger is used to show the member's liability for having signed as a co maker or endorser on another member's note. If there are any co makers on a note who are members of the credit union, it is essential that their liability be recorded. This information need not be shown on the Individual Share and Loan Ledger if a supplementary record is maintained.

When a member has a loan outstanding and is granted a second loan the new loan should be entered on a separate Individual Share and Loan Ledger. A separate Cash Received Voucher should be prepared to reflect repayment on each loan and the voucher should identify the specific loan to which the payment applies.

Maintaining the Note Record on the Individual Share and Loan Ledger

The use of the "Note Record" at the top of the standard Individual Share and Loan Ledger is optional if the "Delinquency Control" or another control record is maintained. It is recommended that each note be recorded here so that it will not be necessary to refer to the note itself to determine the terms of repayment.

Maintaining the Delinquency Control on the Individual Share and Loan Ledger

The standard Individual Share and Loan Ledger contains two columns which are designated as "Delinquency Control." Although the maintenance of the "Delinquency Control" is optional if the "Note Record" or another control method is kept, it does provide a method for a quick analysis of the loans for

the purpose of determining whether they are delinquent and, if so, the extent of such delinquency.

WHEN PAYMENTS ON LOANS ARE RECEIVED

Collection of Interest

Interest is usually collected at the time a repayment on principal is made. Interest rates and finance charges may not exceed the maximum rate permitted by the Federal Credit Union Act.

Interest may be calculated and collected on either a 360- or 365-day basis per year. Further information on these two bases of computing interest is presented in the following paragraphs. Applied uniformly, the true annual interest rate is 15 percent for the interest charge of 1.25 percent per month on the unpaid balance, whether the 365-day year or a 360-day year (30-day month) method is used. Whichever method is used it must be used exclusively.

A mixture of the two methods on a loan between disclosure and actual entered collection *could* result in an improper interest charge (i.e., 365 day computation of interest for disclosure purposes and a 360-day computation for the note and actual collection of interest). Under the 360-Day Method, if a month such as February has only 28 days, the borrower is charged 30 days of interest. Because of the increased accuracy of 365-Day Method, it is recommended that this method be used in calculating interest charges and repayment amounts.

365-Day Year Method

Interest charges based upon a 365-day year can be applied to all repayment contracts, whether written for weekly, biweekly, semimonthly, monthly or other terms. Interest should be computed on the basis of the actual number of days elapsed since the last date through which interest was previously paid or if it is the first payment, since the date the loan was granted. If daily interest factors are developed to aid in computing interest, they must be based upon a 365-day year.

30-Day Month Method (360-Day Year)

This method may be advantageous for those credit unions which make loans based upon monthly repayment terms, or fractions or multiples of monthly repayment terms. The most popular of these repayment terms is the loan calling for payments on the same date each month; other terms call for payments semimonthly or annually. If factors are developed to aid in computing interest on the basis of a 30-day month, they must be based on 360 days (30 days times 12 months).

When applying the 30-day month method, each month is considered to have 30 days regardless of the actual number of days in the month. For instance, under this method, March is considered to have 30 days even though it actually has 31 days. If payments are made on the same date each month, one month's interest charged regardless of whether the month that has elapsed actually had 28, 29, 30, or 31 days.

When payment is made before a full month has elapsed, interest is charged for the exact number of days (based on the 30-day month). As an example, if a payment was made on March 12 and the next payment is made on April 5, interest would be charged for 23 days (23/30ths) (31st of March is not counted).

When more than one full month has elapsed since the previous payment, interest is charged for the full month(s), plus the additional days (computed similar to the instructions in the previous paragraph). As an example, if payment on a loan was made on March 29 and the next payment is made on June 4, interest would be charged for two full months (March 30 to May 29), plus 5 days (May 30, June 1, 2, 3, 4) (31st of May not counted) or (65/30ths).

Grace Period

To ease the task of computing interest, the board of directors may permit a grace period of up to seven days following the due date of each payment. No late charges or additional interest charges are assessed if the payment due is received during that period.

Accrual of Interest

Interest on a loan should begin to accrue upon the disbursement of the loan proceeds. Where the borrower's principal residence (or property which is expected to be used as the borrower's principle residence) is to serve as security for a loan (except for related first mortgage loans), the loan proceeds should not be disbursed until it is determined that the borrower does not intend to rescind that transaction as provided by Regulation Z. When loan drafts are involved, the question arises whether a credit union incurs a liability at the time authorization is issued for a draft to be drawn upon it or whether no liability exists until the draft is accepted. The influencing factors are of a legal nature and may vary in different jurisdictions; the credit union is advised to seek advice from its attorney in determining when the draft becomes a loan and when the interest begins to accrue.

METHODS OF CALCULATING INTEREST**United States Rule-Simple Interest**

Under the United States Rule, a loan payment must be applied to the accumulated interest up to the date of the payment. Any remainder is then credited as a deduction from the principal; successive interest is computed from a declining unpaid balance each time a loan payment is made. If a payment is not sufficient to meet the simple interest which has accrued during the elapsed payment period, such shortfall of interest will be met from subsequent payment or repayments. If a loan payment is insufficient to cover the interest due, the balance of the interest is not added to the principal so as to produce interest.

Level Payment

This method of repaying a loan involves payment of equal installments that consist of principal and interest over the life of the loan. As the loan matures, payments to principal become greater as interest charges become smaller.

Principal Payment Plus Interest

Repayment of a loan following this method involves equal payments to principal while interest payments are larger during the early stages of the loan and become smaller as the principal balance declines. An

advantage of principal plus interest is its ease in the computation of delinquency. A possible disadvantage is that the total loan payment differs from one payment to the next.

Rule of 78

Federal credit unions are not allowed to charge a penalty for the early payoff of a loan. (See Federal Credit Union Act, Section 107(5).) Since the use of the Rule of 78 may result in a penalty being charged to the member, the computation of loan interest using the Rule of 78 may conflict with the law.

Actuarial Method

The actuarial method involves the compounding of interest when a loan payment is greater than a unit period (the period established in the contract for regular payments). The actuarial method requires the addition to the outstanding principal balance any shortfall of interest which occurs at a payment period.

Interest Rates in Relation to Different Classification of Loans

The board of directors has the power to establish interest rates for loans (including lines of credit) based on written classifications established by the board. Classifications should be based upon factors that achieve a sound and legitimate business practice. Examples of lending policies which achieve this are illustrated below:

a) Real Estate Loans

A federal credit union with a large field of membership is granting real estate loans to members located in different areas of the United States. The board of directors could establish a policy to achieve competitive interest rates within local real estate markets. Example policy: Conventional long-term real estate loans originated in city A will be granted at X % and in city B, at Y %.

b) Amount Of The Loan

The board of directors desires to establish interest rates based on the amount of the loan. Example policy: all unsecured loans with balances not exceeding a specific amount will be granted at X% and all un-

secured loans exceeding the specified amount will be granted at Y%.

c) Maturity Of The Loan

A board of directors may desire to match loan maturities/interest rates to corresponding share certificate maturities/dividend rates. The board of directors could establish the following policy. Example policy: All loans with maturities not exceeding 6 months will be granted at X% and all loans with maturities exceeding 6 months will be granted at Y%.

d) Method Of Payment

A board of directors of a federal credit union which has documented cost evidence of an administrative savings for loans repaid via payroll deduction, direct deposit, or transfer from a share account may establish a policy to pass this savings on to the borrowers. Example policy: All loans repaid via voluntary payroll deduction will be granted at X% and all loans repaid by other means will be granted at Y%.

e) Sound Social Policy (Cooperative Spirit)

A board of directors could establish a policy to promote energy conservation. Example policy: All loans secured by automobiles which have an EPA estimated miles per gallon rating of 25 or more will be granted at X% and other loans secured by automobiles will be granted at Y%.

Any interest rate established within a loan classification should be consistent with cooperative principles and existing laws and regulations. Proper use of this power could reduce the operating cost to the credit union and allow the board of directors to better manage the loan portfolio. In addition, the borrower can benefit from the varying interest rates.

Repayment Plans

There are a number of repayment plans, any of which a credit union may use. The most common loan repayment plans are weekly, biweekly, semimonthly, and monthly. It may be convenient for some credit unions, such as educational groups to offer a skip payment plan. The terms of repayment and APR

must be properly disclosed. Credit unions are also authorized to offer single payment loans; specific requirements are contained in the NCUA Rules and Regulations.

When a Loan is Refinanced

A loan is refinanced as the result of a new transaction whereby a former loan is replaced by a new loan under the parties' contract and applicable law. The refinanced loan may involve the consolidation of several existing loans, disbursement of new money to the borrower on the borrower's behalf, or the re-scheduling of payments under the existing loan. In any form, the new loan must completely replace the prior one in order to be considered a refinanced loan. The mere addition of the accrued interest to the outstanding balance of any existing loan balance would not in itself constitute a refinancing. Loans should not be refinanced or extended for the purpose of eliminating them from the delinquent list.

When a loan is to be refinanced, application should be made in an amount sufficient to repay in full the balance of the outstanding loan plus the additional amount of cash desired by the member. The proper entry is illustrated in the third illustrative entry in the description of "Loans." Payment of interest is not shown in this entry since the collection of accrued interest due from the member can be handled by one of the following alternatives:

- a) correct the interest due in cash as a separate transaction;
- b) include it in the amount of the new loan, or
- c) defer it until the time of the first payment under the new obligation interest to be paid in conjunction with the first payment and not deducted from it.

Under alternatives (a) and (c), no Truth in Lending disclosures are required for accrued interest payments; alternative (b) requires Truth in Lending disclosure in the normal manner (as part of the loan proceeds). The accrued interest in alternative (b) must also be disclosed in the note form (contract).

When a Loan is Extended

Extension means amending or supplementing the terms of the original note to achieve a reduction in the original contracted note's scheduled or systematic repayments without supplying additional money. The change in the original terms of the loan would not be subject to disclosure requirements of Truth in Lending Regulation Z.

An extension agreement should be treated in the same fashion as a note. It should be typed or prepared in ink (signed by the borrower in ink). If an error is made on the agreement, a new one must be prepared. Regulations of the Federal Housing Administration prohibit the extension of the maturity of an insured Title I Property Improvement Loan.

When a Loan is Deferred

Deferral means a temporary interruption of the established systematic repayment schedule which involves one or more full payments with no change in the existing terms of the loan, and in which no charge is made other than the additional interest which would accrue on the unpaid balance. The interest is calculated by applying a stated percentage to the unpaid monthly loan balance. A deferral, as defined, will not require additional disclosures under Regulation Z. A deferral must be supported by a written acknowledgment obtained from the member; it must be approved by the credit committee or loan officer and all co-applicants and/or co-makers.

Assessment of Late Charges

Article XII of the Standard Federal Credit Union Bylaws provides for the assessment of late charges. Subject to the limitations of applicable law and regulations, any member whose loan is delinquent may be required by the board to pay a late charge.

In the event a periodic late charge is waived, the credit union can only assess a late charge on that portion of the total outstanding interest that represents the interest that has accrued since the last payment was made. It cannot assess a late charge based on a percentage of the total outstanding interest.

Troubled Debt Restructuring

Troubled debt restructuring results when the credit union grants concessions to the member that would not ordinarily be granted in light of the member's financial condition. Restructuring often involves a reduced interest rate, payment amount, or principal amount; or increased collateral requirements. Routine changes in debt terms and loan deferrals (temporary interruption of payments which change only the maturity date) are not considered troubled debt restructurings.

There are two primary types of restructuring:

- (a) a transfer of assets from a member to the credit union in settlement of a debt and
- (b) a modification of terms.

Whatever the form of concession granted, the object is to increase the probability of recovering the loan. In this regard, the credit committee and loan officers should fully understand the member's needs and financial condition before approving actions to modify loan terms. Some credit unions may require that members make several payments in accordance with the proposed loan terms to assure they will be able to comply with these new terms. During this interim period, the loan should remain delinquent. After several payments are made in accordance with the proposed modified loan terms, proper actions can be taken based on a complete evaluation of the member's financial condition and collateral.

In addition to evaluating the member's financial condition, the credit committee or loan officer should determine the current value of any collateral securing the loan. The credit committee or loan officer must determine that the restructured loan maturity is not extended beyond the useful life of the collateral and that additional collateral is obtained if needed.

Transfer of Assets in Settlement of Debt

A credit union may accept assets from the member in partial or full satisfaction of a debt, such as in the case of a repossession or foreclosure. If receipt of the asset is considered full satisfaction of the debt, the credit union should record the asset at fair value, reducing the balance of the debt accordingly. If the fair value of the asset is less than the balance of the

loan, the excess should be charged-off to the *Allowance for Loan Losses* account. After restructuring the debt, the credit union should account for the assets as if they had been acquired for cash. Gains and losses on the sale should be recorded in the current period income statement.

Illustrative Entries

- a) If the asset value exceeds the balance of the troubled loan:

Current principal balance	\$7,397
Delinquent interest (3 months)	103
Fair value of asset	8,000

The restructuring would be recorded as follows:

Dr. - Assets Acquired	\$8,000
Cr. - Loans	\$7,397
Cr. - Income from Loans	103
Cr. - Payable to the Member (return may be required by loan contract terms or law of jurisdiction)	500

- b) If the balance of the troubled loan exceeds the asset value:

Current principal balance	\$7,397
Delinquent interest (3 months)	103
Collateral Value	6,000

The restructuring would be recorded as follows:

Dr. - Assets Acquired	\$6,000
Dr. - Allowance for Loan Loss (ALL)	1,397
Cr. - Loans	\$7,397

Note: Neither current nor deferred income is recognized in this case.

- c) If the asset were later sold for \$8,000 cash:

Dr. - Cash	\$8,000
Cr. - Assets Acquired	\$6,000
Cr. - Gain on Disposition of Assets	2,000

- d) If the asset were later sold for \$5,000 cash:

Dr. - Cash	\$5,000
Dr. - Loss on Disposition of Assets	1,000
Cr. - Assets Acquired	\$6,000

Modification of Terms

A modification of terms may consist of any or all of the following:

- Reduction (absolute or contingent) of the stated interest rate for the remaining original life of the debt;
- Extension of the maturity date at a stated interest rate lower than the current market rate for new debt with similar risk;
- Reduction (absolute or contingent) of the principal amount or maturity amount of the debt; or
- Reduction (absolute or contingent) of accrued interest.

The result of restructuring through modification of terms is essentially a replacement of the old loan on the books. No special accounting is required unless the total future cash receipts specified by the new terms of the loan (including both interest receipts and principal receipts), are less than the recorded receivable before restructuring. In this case, the recorded balance should be reduced with the excess amount charged-off as a loss.

Illustrative Entries

- a) Suppose the present value of future cash receipts equals the current principal balance plus delinquent interest:

Current principal balance	\$7,397
Delinquent interest (10 months)	103

New loan terms:

Payment	\$260
Interest	15%
Term	36 months
Present Value	\$7,500

The new loan would be recorded as follows:

Dr. - Loans	\$7,500	
Cr. - Loans		\$7,397
Cr. - Accrued Interest on Loans		31
Cr. - ALL		72

This entry records the new loan principal balance of \$7,500 which equals the old loan principal balance plus delinquent interest. This entry also reverses the accrual of income (assuming the permissible accrual equal to three months of the delinquent interest (\$103 times 3/10 equals \$31)) and reduces the amount of loan provision (bad debt expense) necessary for the period by increasing the *Allowance for Loan Losses* by the balance of the remaining delinquent interest (\$103 minus \$31 equals \$72) to be recognized over the remaining life of the loan. The present value of the future loan payments equals the new loan balance; therefore, no adjustment to the new loan balance is required.

b) Suppose the present value of future cash receipts is less than the current principal balance:

New loan terms:

Payment	\$250
Interest	15%
Term	36 months
Present Value	\$7,212

Because the present value of these future cash payments (\$7,212) is less than the current principal balance (\$7,397), the difference (\$185) must be charged-off as a loss, and no current or deferred income would be recognized. In addition, the three months of permissible accrued interest on a delinquent loan (assuming it had been booked) must be charged-off:

Dr. - Loans	\$7,212
Dr. - ALL	216
Cr. - Loans	\$7,397
Cr. - Accrued Interest on Loans	31

Combination Restructuring

If the restructuring involves a receipt of assets in partial settlement and a modification of terms, the loan is first reduced by the fair value of the assets received, then the new loan is recorded in accordance as described above. No loss is recognized unless the balance after recording the fair value of the asset exceeds the present value of future cash receipts under the modified loan terms.

Capitalizing Delinquent Interest

Troubled loans are likely to have delinquent interest at the time of restructuring. In these cases, assuming the credit union has accrued and recognized the permissible three-months interest, a credit union must reverse the interest accrual at the time of restructuring. Delinquent interest in excess of three months is also capitalized as part of the loan asset but must also be credited to the *Allowance for Loan Losses*, thereby reducing the amount of provision (bad debt expense) necessary for the period.

Continuing the previous example, the following entry would be made for the first month following restructuring of the loan:

Dr. - Cash	\$260
Cr. - Loans	\$166.25
Cr. - Income from Loans	93.75

Legal Fees and Other Direct Costs of Restructuring

Legal fees and other direct costs, including direct loan origination costs, incurred by the credit union in the process of restructuring should be recognized as expense in the period incurred.

NET ORIGATION FEES AND COSTS

This section sets forth the regulatory accounting requirements for Federal credit unions in accounting for nonrefundable fees and costs associated with originating and acquiring loans. Originating and acquiring loans includes: lending, committing to lend, or purchasing a loan or group of loans.

This section applies to all types of loans extended by credit unions including consumer loans, mortgage loans, commercial and agricultural loans.

Nonrefundable Loan Origination Fees And Costs

Credit unions under \$10,000,000 in total assets may opt to use the modified cash basis of accounting. These credit unions are required, at a minimum, to amortize loan origination fees on real estate loans over the life of the loan or ten years, whichever period is shorter.

Credit unions following generally accepted accounting principals (GAAP) must use the full accrual basis of accounting. These credit unions must follow the provisions detailed below, unless the difference is not material. The provisions in this section are usually material when applied to real estate and commercial loans.

Loan Origination Fees

Origination fees are nonrefundable fees charged to the borrower in connection with the originating, refinancing or restructuring of a loan. Examples include points, management, arrangement, placement, application, underwriting, and other fees related to a lending transaction. Points charged to sellers shall be considered origination fees.

Direct loan origination costs include the following:

- a) Incremental direct costs incurred in transactions with third parties, and
- b) Certain costs relating to specific activities performed by the lender for that particular loan. The specific activities are:

- 1) Evaluating the applicant's financial condition;

- 2) Evaluating and recording guarantees, collateral and security arrangements;
- 3) Negotiating loan terms;
- 4) Preparing and processing loan documents; and
- 5) Closing the transaction.

These costs should include only that portion of the employee's total compensation and payroll related fringe benefits for the time spent on a particular loan and other costs related to those activities on a particular loan. All other lending related costs should be expensed as incurred. Administration costs such as rent, depreciation, etc., are considered indirect costs and should be expensed as incurred. Also, direct costs do not include transactions with third parties billed directly to the applicant.

Loan origination fees should be deferred and recognized over the life of the loan as an adjustment of yield. Likewise, direct loan origination costs should be deferred and recognized over the life of the loan as a reduction in yield. The fees and costs should be offset against each other and only the net amount should be deferred and amortized. The netting of fees and costs should be applied on an individual loan basis. The net amount should be deferred and amortized using the interest method. The objective of the interest method is to arrive at periodic interest income at a constant effective yield on the net investment (carrying value). The difference between the periodic interest income so determined and the stated interest on the outstanding principal balance is the amount of periodic amortization.

Loan origination fees charged a member and the related direct loan origination costs incurred for loans are offset with the net amount deferred and recognized over the life of the loan as an adjustment of yield using the interest method. The netting of fees and costs are applied on an individual loan basis although aggregation of similar loans is permissible under certain conditions. The practice of recognizing loan origination fees as income in the period earned/received and expensing related costs when incurred or in the period the loan is granted is no longer acceptable. The objective of the interest

method is to arrive at periodic interest income at a constant effective yield on the net investment (carrying value).

Examples of the types of loan origination costs a federal credit union defers include costs related to evaluating the prospective borrower's financial condition, evaluating and recording guarantees, collateral and other such arrangements, negotiating loan terms, preparing and processing loan documents and closing the transaction. The federal credit union may only defer the portion of employee compensation and fringe benefits directly related to time spent on a specific loan as well as other costs incurred in connection with the loan.

All other lending related costs are charged to expense as incurred. This includes:

- Advertising costs, soliciting potential borrowers;
- Servicing existing loans;
- Activities related to establishing and monitoring credit policies;
- Supervision and administration;
- Employees' compensation and fringe benefits related to those activities;
- Unsuccessful loan origination efforts;
- Idle time; and
- Rent, depreciation, and all other occupancy and equipment costs.

Amounts of loan origination, commitment and other fees and costs recognized as an adjustment of yield are reported as part of interest income. The unamortized balance of loan origination, commitment and other fees and costs recognized as an adjustment of yield are reported on the federal credit union's balance sheet as part of the related loan balance.

Commitment Fees

Generally, fees received for a commitment to originate or purchase a loan or a group of loans are offset with direct loan origination costs to make a commitment and deferred. If the commitment is exercised, the net fees are recognized over the life of the loan as an adjustment of yield or, if the commitment expires unexercised, recognized in income upon expiration of the commitment. If the likelihood the commitment will be exercised is remote, the commitment

fee is recognized over the commitment period on a straight-line basis as service fee income. If the commitment is subsequently exercised during the commitment period, the remaining unamortized commitment fee at the time of exercise is recognized over the life of the loan as an adjustment of yield.

Credit Card Fees

If material, fees periodically charged to cardholders must be deferred and recognized on a straight-line basis over the period the fee entitles the cardholder (member) to use the card.

Demand Loans

For a loan that is payable on demand, any net fees or costs may be recognized as an adjustment of yield on a straight-line basis over a period that is consistent with (1) the understanding between the borrower and lender or (2) if no understanding exists, the lender's estimate of the time period the loan will remain outstanding. Any unamortized amount is recognized when the loan is paid in full.

Revolving Lines Of Credit

For revolving lines of credit and other similar loan arrangements, the net fees or costs are recognized in income on a straight-line basis over the period the revolving line of credit is active, assuming the borrowings are outstanding for the maximum term provided in the loan contract. If the borrower pays down the borrowings and cannot borrow again under the contract, any unamortized net fees or costs is recognized in income when paid. The interest method is applied to recognize net unamortized fees or costs when the loan agreement provides a schedule for payment and no additional borrowings are provided for under the agreement.

Purchase Of A Loan Or Group Of Loans

The initial investment in a purchased loan or group of loans includes the amount paid to the seller plus any fees paid or less any fees received. The initial investment frequently differs from the related loans principal amount at the date of purchase. This difference is recognized as an adjustment of yield over the life of the loan. All other costs incurred in connection with acquiring purchased loans or commit-

ting to purchase loans are charged to expense as incurred.

The purchaser may allocate the initial investment to the individual loans or may account for the initial investment in the aggregate. The cash flows provided by the underlying loan contracts is used to apply the interest method. If prepayments are not anticipated and prepayments occur or a portion of the purchased loans are sold, a proportionate amount of the related deferred fees and purchase premium or discount is recognized in income so the effective interest rate on the remaining portion of loans continues unchanged.

Aggregation Of Similar Loans

If the federal credit union holds a large number of similar loans for which prepayments are probable and the timing and amount of prepayments can be reasonably estimated, the federal credit union may use estimated principal repayments to calculate the constant effective yield used in the interest method.

If the federal credit union anticipates prepayments in applying the interest method and a difference arises between the prepayments anticipated and actual prepayments received, the federal credit union calculates the effective yield reflecting the actual payments to date and anticipated future payments. The net investment in the loans is adjusted to the amount that would have existed had the new effective yield been applied since the acquisition of the loans. The investment in the loans is then adjusted to the new balance with a corresponding charge or credit to interest income.

Federal credit unions that anticipate prepayments must disclose the policy and significant assumptions underlying the prepayment estimates. The practice of recognizing net fees over the estimated average life of a group of loans is no longer acceptable.

Definitions

Commitment Fees. Fees charged for entering into an agreement that obligates the Federal credit union to make or acquire a loan or satisfy an obligation of the other party under a specified condition. Commitment fees include fees for letters of credit and obliga-

tions to purchase a loan or group of loans and pass-through certificates.

Credit Card Fees. The periodic uniform fees that entitle cardholders to use credit cards including fees received in similar arrangements, such as charge card and cash card fees.

Incremental Direct Costs. Costs to originate a loan that (1) result directly from and are essential to the lending transaction and (2) would not have been incurred by the lender had the lending transaction not occurred.

Lending Activities. Lending, committing to lend, refinancing or restructuring loans, arranging standby letters of credit, syndication and participation fees to the extent they are associated with the portion of the loan retained by the lender.

Origination Fees. Fees charged to the borrower in connection with the process of originating, refinancing, or restructuring a loan including points, management, arrangement, placement, application, underwriting and also syndication and participation fees to the extent they are associated with the portion of the loan retained by the lender.

Accounting Entries, Loans And The Interest Method

Entries in the Journal and Cash Record

Net fees (costs) and their subsequent amortization should be recorded in the miscellaneous columns of the Journal and Cash Record. The unamortized balance of the net fees (costs) should be reported as part of the loan balance to which it relates. The periodic amortization should be reported on the income statement as interest income.

Illustrative Entries

Assume that a \$75,000 real estate loan is made 1/01/X1 at 10% interest. The loan is to be paid back in 15 annual installments. The credit union charges points of 3%. Direct costs were \$250.

Step 1-Determine the carrying amount of the loan:

Principal Balance of Loan	\$75,000
Less: Fees Charged	(2,250)
Plus Direct Costs	250
Carrying Amount	\$73,000

Step 2-Determine the unamortized net fees:

Fees Charged	\$2,250
Less: Direct Costs	(250)
Unamortized Net Fees	\$2,000

Step 3-Determine the yearly payment on the amount of the loan. (Note: A pocket calculator with present value/annuity capability can be used to determine the yearly value payment). In this case, the yearly payment is \$9,861.

Step 4-Determine the constant effective yield on the carrying amount, \$73,000. (Note: Again this can be done using a pocket calculator with present value capability). In this example, the constant effective yield based on the carrying amount is 10.4782 percent.

Step 5-Determine the amount of periodic amortization.

Year 1

- Stated interest based on the outstanding principal balance = \$75,000, ($\$75,000 \times 10\%$).
- Interest income based on the carrying amount and the constant effective yield = \$7,649, ($\$73,000 \times .104782$).
- Amount of amortization for year 1 = \$149, ($\$7,649 - \$7,500$).
- Total interest income for year 1 = \$7,649, ($\$7,500 + \149). ($\$73,000 \times .104782$).
- Outstanding principal balance at the end of year 1 = \$72,639, ($\$75,000 - \$9,861 + \$7,500$).
- Carrying amount at the end of year 1 = \$70,788, ($\$72,639 - \$2,000 + \149).

- Net unamortized fees (costs) would be \$1,851, ($\$2,000 - \149).

Year 2

- Stated interest based on the outstanding principal balance = \$7,264, ($\$72,639 \times 10\%$).
- Interest income based on the carrying amount and constant effective yield = \$7,417, ($\$70,788 \times .104782$).
- Amount of amortization for year 2 = \$153, ($\$7,417 - \$7,264$).
- Total interest income for year 2 = \$7,417, ($\$7,264 + \153).
- Outstanding Principal balance at the end of year 2 = \$70,042, ($\$72,639 - \$9,861 + \$7,264$).
- Carrying amount at the end of year 2 = \$68,344, ($\$70,042 - \$1,851 + \153).
- Net unamortized fees (costs) would be \$1,698, ($\$1,851 - \153).

Each succeeding year's computations would be calculated exactly the same as years 1 and 2. Should the borrower make a full repayment of the outstanding principal balance, any net unamortized fees (costs) would be taken directly into interest income.

a) To record the net origination fees (costs) per the above example.

Dr. - Cash	\$2,000
Cr. - Net Origination Fees	
(Costs)-Real Estate Loans	
Over 12 years	\$2,000

b) To record the amortization of the net origination fees (costs) when the first scheduled payment is made.

Dr. - Net Origination Fees	
(Costs)-Real Estate	
Loans Over 12 years	\$149.00
Cr. - Interest on Real Estate	
Loans	\$149.00

c) To record the amortization of the net origination fees (costs) when the second scheduled payment is made.

Dr. - Real Estate Loans Over 12 Years-Net Origina- tion Fees (Costs)	\$153.00
Cr. - Interest on Real Estate Loans	\$153.00

d) To record the transaction as it pertains to the net unamortized fees (costs) should the borrower make a full prepayment when the third scheduled payment is due.

Dr. - Real Estate Loans Over 12 Years-Net Origina- tion Fees (Costs)	\$1,698.00
Cr. - Interest on Real Estate Loans	\$1,698.00

Note: When the stated rate of interest changes during the term of the loan the interest method is applied as follows:

1) Should the stated interest rate increase during the term of the loan so that the interest accrued under the interest method in early periods would exceed interest at the stated rate, interest income shall not be recognized to the extent that the net investment in the loan would increase to an amount greater than the outstanding balance of the loan. In such a case, the amortization of the net fees calculated by subtracting the stated interest from the interest income based on the net investment would exceed the total unamortized fees. Therefore, the interest income is limited to the stated interest plus the unamortized net fees (costs).

2) Should the stated rate decrease during the term of the loan, the stated interest calculated early in the term of the loan would exceed interest income based on the net investment. In such a case the excess is deferred and added to the unamortized net fees thereby increasing the net investment in the loan.

3) If the loan's stated rate varies based on an independent index or rate, the calculation of the constant effective yield shall be based either on the rate in effect at the inception of the loan or on the factor as it changes over the life of the loan.

If the constant effective yield is based on the rate in effect at the loan's inception, then the amortization of the net fees (costs) would be the same as if the rate had not changed. Therefore, the interest income equals the stated interest plus the amortization of the net fees (costs) on the terms of the loan at inception.

If the constant effective yield is based on the factor as it changes over the life of the loan, then a new constant effective rate would be computed when the rate changes.

Problems also can be encountered when the scheduled payment and/or payment dates are not met. Therefore, it is essential in such cases that professional assistance be consulted and that the software necessary to amortize the net fees (costs) be obtained.

If a credit union has a large number of similar loans for which prepayments are probable and the timing and amount of the prepayments can be reasonably estimated, the credit union may consider estimates of future principal payments in the calculation of the constant effective yield. If this approach is taken and a difference arises between the prepayments received and the prepayments anticipated, the effective yield should be recalculated to reflect actual payments to date and anticipated future payments. The net investment in the loans shall be adjusted to the amount that would have existed had the new effective yield been applied since the acquisition of the loans. The investment in the loans shall be adjusted to the new balance with a corresponding charge or credit to interest income. Credit unions that anticipate prepayments shall disclose that policy and the significant assumptions underlying the prepayment estimates. Detailed examples are not provided due to the complexity of the subject matter. Professional assistance should be consulted if this procedure is being contemplated.

When a borrower refinances or restructures a loan and the terms are at least as favorable to the lender as the terms for comparable loans to other members with similar collection risks who are not refinancing or restructuring, the refinanced loan should be accounted for as a new loan. Any unamortized net fees (costs) from the original loan shall be recognized as interest income when the new loan is granted.

If the refinancing does not meet the conditions discussed in the preceding paragraph, then the net fees (costs) from the original loan shall be carried forward as a part of the net investment in the new loan.

Detailed Transactions

Debit:

- a) With the amount of direct loan costs incurred.
- b) With the amount of periodic amortization of the net fees.

Credit:

- a) With the amount of loan origination fees received.
- b) With the amount of periodic amortization of the net costs.

ALLOWANCE FOR LOAN LOSSES

The allowance for loan losses (ALL) is an accounting estimate of credit union losses inherent in a credit union's portfolio that have been incurred at the Statement of Financial Condition date. The objective of the ALL is to measure loans at their collectible amounts. The balance of this account is treated on the Statements of Financial Condition as a deduction from the total carrying value of loans and loan derived assets to reflect these assets at their fair value. Thus, the ALL results in a fair presentation of the financial statements in conformity with generally accepted accounting principles (GAAP) and meet regulatory requirements for full and fair disclosure.

Each credit union's method of estimating its ALL is dependent on many factors, including the credit union's size, business environment and strategy, management style, loan portfolio characteristics, loan administration procedures, and data processing systems. Accordingly, there are a variety of methods that may be used. GAAP sometimes limits the methods that may be used to evaluate the adequacy of the ALL. For example, credit unions should use the expected future cash flows discounted at the loan's ef-

fective interest rate for certain complex loans (e.g., commercial loans).

For credit unions with less than \$10 million in assets, the calculation to determine the adequacy of the ALL as outlined in this manual remains consistent with GAAP. While this Accounting Manual provides sufficient ALL guidance for most other credit unions, management is advised to consult the applicable GAAP statements and/or consult their independent accountant for additional guidance.

Policy. Federal credit unions must determine an adequate and reasonable ALL. The ALL should be sufficient to cover estimated losses which exist in the loan portfolio at the financial statement date. Thereby, the ALL results in the fair presentation of financial statements in accordance with GAAP, and meets the requirements for full and fair disclosure. Credit unions must realize that under-funding the ALL, as well as over-funding the ALL, does not result in the fair presentation of financial statements in accordance with GAAP.

GAAP. GAAP requires recognition of an estimated loss if both of the following conditions are met:

- Information available prior to issuance of the financial statements indicates that it is probable that an asset had been impaired or a liability had been incurred at the date of the financial statements. It is implicit in this condition that it must be probable that one or more future events will occur confirming the fact of the loss. The Financial Accounting Standards Board (FASB) recognized that the application of the term "probable" in practice requires judgment, and to clarify its intent the FASB reiterated that probable does not mean virtually certain. Probable is a higher level of likelihood than "more likely than not."
- The amount of the loss can be reasonably estimated. Whether the amount of loss can be reasonably estimated will normally depend on, among other things, the experience of the credit union, information about the ability of individual members to pay, and appraisal of the loans in light of the current economic environment. In the case of a credit union that has no experience in this area, reference to the experience of other

financial institutions in the same business may be appropriate. In all cases, GAAP requires a reasonable basis for quantifying the amount of loss and that estimated losses should be accrued by a charge to income if the above conditions are met.

Management's Responsibility. Credit union management is responsible for summarizing and documenting its evaluation of the loan portfolio's collectibility. The auditor should review management's documentation and consider whether management has incorporated such factors as changes in the nature and volume of the portfolio; overall portfolio quality, loan concentration; trends in the level of delinquent and classified loans; specific problems loans, leases, and commitments; and current and anticipated economic conditions that may affect the borrower's ability to pay. Credit unions should review the adequacy of the ALL at least quarterly, or at the end of each regular share account dividend period, or more often as required. It is also critical that credit union management practice the timely charge-off of "loss loans". Charge-off policies must clearly identify charge-off criteria. For sound internal control, monthly board minutes must reflect the discussion and recognition of identified loan losses.

Adequacy of the ALL. There is no one method that is guaranteed consistently, in all instances and under every circumstance, to ensure that the ALL is adequate and in compliance with GAAP. There are various methods by which management can estimate it's ALL and that no single method is preferable. However, GAAP states that the method used should be consistent, comprehensive, logical, and relevant to the institution's particular circumstances, and that the calculation should be comprehensive, taking into account the risks inherent in the various types of lending.

Examples of categories often used include:

- a) A specific portion to cover specifically identified doubtful or troubled loans.
- b) A specific portion for pools of classified loans.
- c) A specific portion for pools of homogeneous loans.

NCUA allows a range of loss or an estimated loss percentage associated with each component for non-complex type loans. The percentage is then applied to the individual components. Management should ensure that loans are not excluded from a component or segment. The estimated losses associated with the individual components are accumulated to assist in the ALL evaluation. Analytical methods alone generally do not produce acceptable results; therefore, management may wish to perform detailed loan reviews.

In evaluating the amount or range of loss associated with an individual loan, management should review the expected sources of repayment and the apparent ability of the borrower to generate such repayment.

Management Considerations. Loan underwriting is strongest, and the need for a substantial ALL least likely, when management:

- a) Understands the lending environment and appreciates the value of credit strategy and credit risk including: collateral risk, concentration risk, management risk, operations risk, and fraud or insider abuse risk.
- b) Establishes a good system of lending policies, procedures and internal controls to guide loan origination and disbursement: credit initiation, credit investigation, loan approval, documentation of credit, perfection of collateral interest, disbursement of loan proceeds, credit monitoring, collection, and internal loan review.

Examination Testing. Credit union management is responsible for determining an adequate ALL and adopting a reasonable methodology in accordance with GAAP and regulatory requirements. NCUA is responsible for testing the adequacy of the ALL credit union management has so determined, during, and within the limitations of, the annual examination. NCUA examiners will check the adequacy of the ALL by using the following test as a guideline. While this method may produce results that approximate an acceptable ALL under GAAP, it tends to be conservative, and care must be taken in interpreting the results.

1) Review each delinquent or non-performing loan and selected large loans and determine the amounts that are losses or doubtful of collection (Adjustment Method). Refinancing and extension agreements without an adequate payment history would be considered non-performing. Add the anticipated loss amount for each loan.

2) Compute the credit union's 5-year average loss ratio (Experience Method). *Determine whether this is a reasonable ratio to apply to the balance of the loan portfolio in light of current economic conditions and unusually high or low charge-offs in prior periods.* Multiply this ratio by total loans outstanding less loan balances for loans which have been individually classified and reserved for per step (1). For those credit unions which maintain sufficient detail, computing a loss ratio for each loan category (i.e., auto, real estate, business, etc.) would be appropriate.

Note: *Examiners have been instructed to use their judgment. The analysis and estimate of probable losses in the ALL, especially in step (2), should be tempered by economic realities, i.e., it may be appropriate to shorten the historical time period during periods of significant economic expansion or contraction to more accurately reflect loss expedience in the current economic climate. The loss ratio may be adjusted upward or downward based on the asset quality cycle (i.e., stable, declining or improving).*

3) The sum of steps (1) and (2) above are compared to the existing ALL account balance and the balance adjusted if it is materially different and there are no extenuating circumstances.

Definition of Contingency. An existing condition, situation, or set of circumstances involving uncertainty as to possible gain (a gain contingency) or loss (a loss contingency) to an enterprise that will ultimately be resolved when one or more future events occur or fail to occur.

Illustrative Entries:

The following illustrates common general ledger transaction involving the ALL:

a) To establish or increase the credit balance, and to eliminate a debit balance, in this account:

Dr. - Provision for Loan	
Losses	\$1,000.00
Cr. - Allowance for Loan	
Losses	\$1,000.00

b) To decrease the credit balance in this account:

Dr. - Allowance for Loan	
Losses	\$400.00
Cr. - Provision for Loan	
Losses	\$400.00

c) To record the charge-off of loans when authorized by the board of directors:

Dr. - Allowance for Loan	
Losses	\$350.00
Cr. - Loans	\$350.00

d) To record recoveries realized on loans charged-off:

Dr. - Cash	\$30.00
Cr. - Allowance for Loan Losses	\$30.00

e) When recovery is made on a loan previously charged-off which has been placed in the hands of an outside collection agency and the agency withholds its fee from the amount remitted to the credit union (e.g., paid by borrower, \$17.40; fee withheld, 20 percent; remitted \$13.92):

Dr. - Cash	\$13.92
Dr. - Collection Expense	3.48
Cr. - Allowance for Loan	
Losses	\$17.40

Additional Guidance. Additional ALL guidance can be found in the appropriate GAAP literature. If you have any problems or questions, please call the your examiner, your independent accountant, your NCUA regional office, and/or your state regulator.

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ACCRUED INTEREST RECEIVABLE

These accounts apply to credit unions that are following the full accrual basis of accounting. The accounts may also be adopted for use by credit unions following the modified cash basis of accounting. Credit unions using these accounts should include in their accounts and financial statements interest earned during each month, or other period adopted, instead of including interest only sporadically when received in cash. The recording of income on investments under the accrual procedures set forth in "Accrued Income on Investments" is particularly recommended for credit unions with substantial investments.

ACCRUED INTEREST ON LOANS

For credit unions following the accrual basis of accounting in recording interest on loans, this account reflects the aggregate amount of accrued interest earned but not yet collected on loans outstanding. The accrued interest earned should include the applicable amount of amortization relating to net origination fees. This account also

includes accrued interest earned on notes and contracts receivable from nonmembers (resulting from the assumption of members' real estate loans or the sale of *Assets Acquired in Liquidation of Loans*) and from loans purchased from liquidating credit unions. The accrued interest earned on loans purchased from liquidating credit unions should include the applicable amount of amortization relating to the discount on loans purchased.

At the end of each month the credit union should record in this account, interest earned but not yet received on outstanding loans with an offsetting credit to the "Interest on Loans" account. The computation of interest earned may be derived through manual computations or from computer totals, if applicable.

Interest should not be accrued on loans 3 months or more delinquent. Accruals of interest on loans should be reversed when the loan is determined to be a loss or when it becomes 12 months delinquent whichever occurs first, by debiting the appropriate income account and crediting the appropriate accrued income account. Accrual of interest may

continue, however, if the credit union is receiving substantial payments and expects to receive full payment. Interest collected during the month should be credited to income and the accrual process is then repeated at the next month end. As an alternative to reversing the accrual entry on the first day of the following month, interest collected may be credited to accrued income until that account reaches zero with subsequent interest collections being credited to income.

Adjustments should be made to this account:

- When required based on a periodic verification made to determine actual accrued interest receivable on loans, or on a segment of loans for which a separate sub-control of accrued interest receivable is maintained.
- For accrued interest charged off with the approval of the board of directors, with offsetting debit to "Allowance for Loan Losses".

Entries in the Journal and Cash Record

This account should be debited each month with summary accruals of interest earned based on Journal Voucher entries made in the "Miscellaneous Debit" column. The credits to this account should consist mainly of entries made to reverse accruals. Other entries to this account should be posted from the "Miscellaneous" columns for adjustments, either debit or credit, made to this account.

Illustrative Entries

- a) To record the total interest earned on loans for the month:

Dr.-Accrued Interest on Loans	\$6,500	
Cr.-Interest on Loans		\$6,500

- b) To record reversal of the accrual entry on the first day of the following month:

Dr.-Interest on Loans	\$6,500	
Cr.-Accrued Interest on Loans		\$6,500

- c) If the periodic inventory made to determine whether the balance of this account is equal to the actual interest earned but not collected on outstanding loans show that this account balance is overstated by \$230.00, the entry to adjust would be:

Dr.-Interest on Loans	\$230	
Cr.-Accrued Interest on Loans		\$230

Note: If this account balance is understated, the opposite entry would be made, debiting "Accrued Interest on Loans" and crediting "Interest on Loans".

Detailed Transactions

Debit:

- a) At the end of each month with interest earned on loans outstanding.
- b) With adjustments, subject to the approval of the board of directors, when the periodic inventory to verify this account exceeds the balance of this account.

Credit:

- a) With interest on loans collected.
- b) With adjustments to charge off interest accrued when loans are charged off, subject to the approval of the board of directors.
- c) With adjustments, subject to the approval of the board of directors, when the periodic inventory

to verify this account is less than the balance of this account.

Sample Computations

When the individual loan ledgers are maintained by electronic data processing, the amount of unpaid

interest is usually available on periodic reports. The amount of accrued interest for credit unions on a manual system can be determined by totaling the outstanding loan balances at each effective interest rate and multiplying these totals by the respective interest rate factors. (The figures obtained then have to be adjusted to take into consideration the length of time since the last loan payments.) The formula for this computation is:

Total Loan Balances	X	No. of days interest due	X	Interest rate	=	Amount of Accrued Interest
		365		100		

As a simple example of calculating earned but uncollected interest, assume that as of June 30, a credit union has \$300,000 in loans outstanding at 9% interest and \$400,000 in loans outstanding at 12% interest. Assume further that all loans are

repaid by payroll deductions that are credited on the 15th day of each month. Application of the above formula for each interest rate is illustrated as follows.

\$300,000 Loans outstanding	X	$\frac{15}{365}$	X	$\frac{9}{100}$	=	\$1,109.59
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\$400,000 Loans outstanding	X	$\frac{15}{365}$	X	$\frac{12}{100}$	=	\$1,972.50
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Total accrued interest, June 15 to June 30					=	\$3,082.09
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This manual estimation method would naturally be more complicated whenever the loans have various payment dates that are unevenly spread throughout the month. It is acceptable in those cases to make an estimate of the weighted average number of days since last payment for use in place of the actual number of days in the above method.

To illustrate this procedure, assume that a credit union posts several payroll deductions to loans during the month. The procedure involves totaling the number of days of unpaid interest and the number of loans from each payroll deduction and then dividing the total number of days of unpaid interest by the number of loans outstanding. This procedure is shown on the next page illustration:

Dates of Payroll Deduction Posting	No. of Days To Month-End	No. of Loans	Total No. Days of Unpaid Interest
June 2 - Salaried employees - paid monthly	28	8	224
June 12 - Office employees - paid monthly	18	32	576
June 17 - Supervisors - paid Biweekly	13	18	234
June 25 – Other employees - paid weekly	5	970	4,850
June 29 - Credit Union Employees - paid weekly	1	4	4
		<u>1,032</u>	<u>5,888</u>

The weighted average number of days since the last principle payment = $5,888/1,032 = 5.7$ days. Thus, 5.7 days would be a reasonable estimate of the weighted average number of days since last payment to be used in the above formula for computing accrued interest at month-end.

Combination of cash payments and irregular payroll deductions of various amounts could further complicate estimations of accrued interest. Most credit unions falling into this category probably use electronic data processing systems that automatically provide the necessary information. However, those credit unions on manual systems may design their own method of estimating accrued interest, provided the method results in a reasonably accurate estimate and is consistently applied.

If payroll deductions are received on the same dates every month, interest rates do not change, loan volume is relatively stable, and all loans are repaid on a monthly basis, the amount of interest accrued should not vary greatly from month to month. In many cases, it would be permissible to use the

same accrued figures for a 3-month period. It will be necessary, however, to recalculate the accruals at least quarterly and make any necessary adjustments.

Accruals of interest on loans can be reversed on the first day of the following month by debiting the appropriate income account and crediting the appropriate accrued income account. Interest collected during the month can then be credited to income and the accrual process repeated at the next month-end. As a preferable alternative to reversing the accrual entry on the first day of the following month, interest collected may be credited to accrued income until that account reaches zero with subsequent interest collections being credited to income.

ACCRUED INTEREST ON INVESTMENTS

Purchased Accrued Interest Receivable

This account is used to record the purchase of accrued interest on investments. The purchased

accrued interest accumulated from the date of the last interest payment on the investment to the date of purchase of the investment. The accrued interest receivable should be recorded when the credit union records the purchase of the investment. Refer to the "Investments" section of this manual for further explanation and illustrative entries.

Accrued Interest on Investments

For credit unions using the accrual basis of accounting to record income from investments, this account reflects the total amount of interest earned but not yet collected.

Interest on investments should be debited to this account in each accrual period (monthly, quarterly, or at the end of a regular share account dividend period) to show the actual amount earned in the period based upon the time the investments are owned or held; the offsetting credit should be to the appropriate investment income account. When the interest is received, or credited to the investment account (common trust or mutual fund investments, investments in savings and loans associations, investments in credit union shares, etc.), this account should be credited.

Interest on U. S. Government Obligations and Federal Agency Securities may be accrued on a 30-day month. Interest from other investments normally should be accrued on an actual day (365/366-day year) basis.

Where interest is accrued based on estimates (e.g., income on Common Trust or Mutual Fund Investments or shares in savings and loan associations and other credit unions), an appropriate adjustment to the accrual amounts should be made when the actual amounts are known.

Illustrative Entries

a) To accrue one month's interest on \$12,000 of 5 percent U.S. Government Obligations; semiannual interest amount of \$300.00 is divided by 6 to compute amount applicable to each month:

Dr.-Accrued Interest on Investments	\$50.00
Cr.-Interest from U.S. Government Obligations	\$50.00

b) To estimate and accrue the interest on Common Trust or Mutual Fund Investments, apply the effective rate of interest shown on the most recent advice of interest received to the average balance of the investment for the period; e.g. average investments of \$10,000 x 4.8% rate equals \$480 for a year, current accrual for 1 month - \$480 divided by 12 equals \$40.00:

Dr.-Accrued Interest on Investments	\$40.00
Cr.-Interest from Mutual Funds/Common Trust Investments	\$40.00

c) Building on entry b. above, if the advice of interest credited on the Common Trust or Mutual Fund Investments received in the ensuing month shows income credited for the preceding month as \$46.00, the following adjustment should be made:

Dr.-Available-for-Sale Securities	\$46.00
Cr.-Interest from Mutual Funds/Common Trust Investments	\$6.00
Cr.-Accrued Interest on Investments	40.00

d) Upon receipt of interest from investments:

Dr.-Cash	\$600.00
Cr.-Accrued Interest on Investments	\$600.00

e) To accrue interest on shares in other credit unions, use the applicable rate for the most recent dividend paid by the credit union in which shares are owned and accrue periodic interest as follows:

Dr.-Accrued Interest on Investments	\$300.00
Cr.-Interest from Shares/Deposits/Certificates of Other Credit Unions	\$300.00

Note: When the actual dividend is received, an adjustment of the accrual should be made for the difference, if any, between the estimated and actual interest.

Detailed Transactions

Debit:

- a) With interest earned applicable to the accrual period on all types of investments.
- b) With the amount of accrued interest purchased to the date of acquisition of securities when investments are made in bonds or other securities.

Credit:

- a) With interest and dividends collected or added to the investment account(s), as the transactions occur.

Refer to the “Investments” section of this manual for further information and illustrative entries relative to accounting for investment interest.

OTHER REAL ESTATE OWNED

ASSETS ACQUIRED IN LIQUIDATION OF LOANS

This account reflects the value of assets acquired by the credit union in the liquidation of loans for which the related loan obligation of the borrower has been canceled.

When the credit union takes possession of collateral and the borrower's obligation to the credit union has been canceled, (by legal requirement in some jurisdictions or by some action of the board of directors), then the fair value of the collateral should be transferred to “Assets Acquired in Liquidation of Loans”.

Assets acquired should initially be recorded in this account at the cost of such assets at foreclosure which is fair value of the asset foreclosed or repossessed. Subsequent to foreclosure, the records

should reflect the asset at the lower of (a) fair value minus estimated costs to sell, or (b) cost at the time of foreclosure.

Generally accepted accounting principles require that... such determination should be made on an individual asset basis. If the fair value of the asset minus the estimated costs to sell the asset is less than the cost of the asset, the deficiency should be recognized as a valuation allowance, “Allowance for Impairment Loss”. If the fair value of the asset subsequently increases and the fair value of the asset minus the estimated costs to sell the asset is more than its carrying amount, the valuation allowance should be reduced, but not below zero. Increases or decreases in the valuation allowance should be charged or credited to “Gain (Loss) Due to Disposition/Impairment of Assets”.

The amount of any senior debt (principal and accrued interest) to which the asset is subject should be reported as a liability at the time of foreclosure and not be deducted from the carrying amount of the asset; payments on such debt should be charged to the liability. Interest that accrues after foreclosure should be recognized as interest expense.

If the number of loans that has been transferred to this account exceeds one, then it is necessary to establish a subsidiary account for control purposes. The value of each item should be adjusted to the lower of (a) fair value minus estimated costs to sell, or (b) cost.

If any income is derived (expenses incurred) from the property while the collateral property is in the possession or under the control of the credit union, the net of such revenues and expenses related to operating or holding foreclosed assets held for sale should be credited or charged to income as a gain or loss on holding the assets. Credit union officials must keep in mind that these repossessed assets are to be held only temporarily. Maintaining such property permanently in an income-producing manner is beyond the permitted powers of a federal credit union.

Although not required, it is a good procedure to forward to the member a brief accounting record of the loan reflecting sale and application of the

collateral. Such a procedure can minimize unnecessary questions and possible lawsuits arising from misunderstandings with members.

Illustrative Entries

a) To record the cost of an asset acquired at foreclosure which is the fair value of the asset foreclosed (when the obligation of the borrower has been canceled):

Dr.-Assets Acquired in	
Liquidation of Loans	\$375.00
Dr.-Allowance for Loan	
Losses	25.00
Cr.-Loans	\$400.00

Note: When the outstanding loan balance exceeds the fair value of the collateral at foreclosure, the remaining loan balance (the difference) should be charged off to the allowance for loan losses.

b) To recognize an impairment loss by writing down the carrying value of the asset to the lower of (i) fair value less cost to sell the asset or (ii) cost at time of foreclosure; write-down to \$175 in this case:

Dr.- Gain (Loss) Due to	
Disposition/Impairment	
of Assets	\$200.00
Cr. Allowance for	
Impairment Losses	\$200.00

c) To record the disposition of assets acquired in liquidation of loans -- assume assets carried in "Assets Acquired in Liquidation of Loans" above are sold for \$150.00:

Dr.-Cash	\$150.00
Dr.-Allowance for	
Impairment Losses	200.00
Dr.-Gain (Loss) Due to	
Disposition/Impairment	
Of Assets	25.00
Cr.-Assets Acquired in	
Liquidation of Loans	\$375.00

Note: If, as a condition of the sale, the credit union accepts a note for part or all of the purchase price, the note should be accounted for in "Notes and Contracts Receivable". Refer to "Unamortized Discount on Sale of Assets" in Deferred Credits section of the Liabilities chapter for further explanation and illustrative entries.

Allowance for Impairment Losses

This account represents the impairment loss recognized for assets acquired in liquidation of loans, subsequent to foreclosure. It is the difference in cost (fair value) at the time of foreclosure and the current fair value less estimated costs to sell the asset. Refer to "Assets Acquired in Liquidation of Loans" for further explanation and illustrative entries.

PROPERTY AND EQUIPMENT

Under Section 107(4) of the Federal Credit Union Act, credit unions are authorized to purchase, hold and dispose of property necessary or incidental to their operations. Refer to Part 701.36 of the National Credit Union Administration Rules and Regulations for limitations on amounts which may be invested in fixed assets and on the sources from which real property can be acquired without prior approval of the National Credit Union Administration Board.

LAND

This account reflects the costs to the credit union of land owned by it, except that any land acquired in connection with the liquidation of loans should be recorded in "Assets Acquired in Liquidation of Loans".

When the credit union purchases land, the cost should be recorded in this account. Cost should include the purchase price plus any incidental costs incurred in order to obtain title to the land and place it in condition for use. In combination purchases where land and buildings are acquired in a single transaction, the cost of the land should be recorded in this account based on an estimate of its value at the time of acquisition and the balance of the purchase cost should be recorded in "Building".

Upon disposition of the land and building, the balances for the property recorded in this account and in "Allowance for Depreciation of Building" should be cleared, and any gain or loss credited or debited to "Gain (Loss) Due to Disposition/Impairment of Assets".

Illustrative Entries

- a) When land is purchased, record the entry for the cost incurred as follows:

Dr.-Land	\$15,000	
Cr.- Cash		15,000

Note: If a combined purchase of both land and building is made, the amount charged to this account should be based on an estimate of the portion of the overall cost properly attributable to the value of the land based on fair market value.

- b) When land carried at \$15,000 is disposed of for an \$18,000 sales price:

Dr.-Cash	\$18,000	
Cr.-Land		15,000
Cr.-Gain (Loss) Due to Disposition/Impairment of Assets		3,000

- c) If a combined sale of land and building is made for \$65,000, and the land carrying value is \$15,000, and the building carrying value is \$60,000, with accumulated depreciation of building of \$20,000, the entry would be:

Dr.-Cash	\$65,000	
Dr.-Allowance for Depreciation of Building	20,000	
Cr.- Land		\$15,000
Cr.-Building		60,000
Cr.-Gain (Loss) Due to Disposition/Impairment of Assets		10,000

Detailed Transactions

Debit:

- a) With purchase cost of land and other charges related to acquisition. (In combined purchase of land and building, debit this account with the estimated fair market value of the land.)

Credit:

- a) With book value of land at time of disposition.

BUILDING

A federal credit union may purchase or construct a building for its use, provided the building is necessary and incidental to its operation and the purchase is in compliance with Section 701.36 of NCUA Rules and Regulations. This account should reflect all costs related to the acquisition of the building plus the cost of any additions and improvements of a permanent nature which increase the value of the building.

Depreciation

The following are acceptable useful lives for new buildings based on type of construction:

<u>Type of Construction</u>	<u>Useful Life</u>
Concrete &	
Steel	30-55 years
Masonry	25-45 years
Wood Frame	20-40 years
Portable Units	15-30 years

In selecting a specific useful life within the above ranges, the board of directors should consider such other factors as anticipated use, climatic conditions, economic conditions within the surrounding area, possible future uses of the building site and the surrounding area, and present and future accessibility of the site for the membership. The credit union's files should contain written documentation and support for the period of depreciable life selected, with attention given to all of these factors.

The remaining useful life of a used building should be a reasonable estimate based on the age and condition of the building at the time of acquisition by the credit union.

For purposes of determining the periodic depreciation charge, it is recommended that the salvage value be limited to 10 percent of the cost of the depreciable property (excluding the cost of land) unless a higher salvage value is determined by an independent qualified appraiser at the time of acquisition.

Depreciation charges as a minimum should be recorded at least quarterly or at the end of the regular share account dividend period if it is longer than quarterly. Where the dividend period is more frequent than monthly, the depreciation charge may be recorded on a monthly basis. In determining the periodic depreciation charge, the board may select any of the generally accepted methods of depreciation, such as straight-line, sum-of-the-years digits, or declining balance methods. The depreciation should be credited to "Allowance for Depreciation of Building." The balance in "Allowance for Depreciation of Building" should be deducted from the balance in the "Building" account and the net reflected as the value of the Building in the monthly Statement of Financial Condition.

Expenses

Expenses, including depreciation, incurred in maintaining the building should be recorded in the appropriate expense classification under "Office Occupancy Expenses". Any incidental income received from the building should be credited to "Other Nonoperating Income (Expense)".

Records

All required supporting papers should be kept in the permanent files, including such items as the deed, abstract of title or title insurance policy, and settlement papers. The board of directors must determine that all necessary insurance is purchased, including at least public liability and fire insurance, and should periodically ascertain the need for additional coverage.

Sale of Land and Building

Ordinarily, when a credit union sells its office building, it does so for cash. If, however, as a condition of the sale, the credit union accepts a note for part of the purchase price, the note should be accounted for in "Notes and Contracts Receivable", as discussed in the description of that account.

Illustrative Entries

a) When a building is acquired, the purchase price (excluding value of land purchased and recorded in "Land") plus incidental expenses related to the acquisition, and any expenditures made immediately following acquisition to place the building in condition for use by the credit union should be recorded:

Dr.-Building	\$350,000	
Cr.- Cash		\$350,000

Note: If the acquisition involves borrowing by the credit union secured by a mortgage on the building, the credit should be to "Mortgage Notes Payable" instead of to "Cash".

Detailed Transactions

Debit:

- With purchase cost of building plus amount of related costs incidental to acquisition of title.
- With expenditures made immediately following acquisition to place the building in condition for use by the credit union.
- With the cost of improvements to the building.

Credit:

- With the current carrying value of the building at the time of disposition.

Allowance for Depreciation of Building

This account represents the amount provided for depreciation or obsolescence of a building owned

by the credit union, exclusive of buildings carried as "Assets Acquired in Liquidation of Loans".

The carrying value of the building less estimated eventual salvage value should be depreciated by periodic charges to operating expense over the building's estimated life. The depreciation computation may be made monthly, quarterly, semiannually or annually, but as a minimum, should be made for each regular share account dividend period.

Illustrative Entries

a) To record quarterly straight-line depreciation: building carrying value \$2,000,000; estimated life is 40 years; and anticipated salvage \$200,000. Quarterly depreciation is calculated as \$2,000,000 less \$200,000 divided by 160, representing the number of quarterly periods, equaling periodic depreciation costs of \$11,250:

Dr.-Depreciation of	
Buildings	\$11,250
Cr.-Allowance	
for Depreciation of	
Buildings	\$11,250

b) To record sale of building and land see illustrative entry c) under the description of "Land."

Impairment of Long Lived Assets

If the credit union experiences a significant decrease in the market value of a long-lived asset (e.g., building) that it expects to hold and use, the carrying value of the asset shall be written down to its fair value. The fair value of an asset is the amount at which the asset could be bought or sold in a current transaction between willing parties, that is, other than a forced or liquidation sale. The loss will be recognized as a current operating expense, "Gain (Loss) Due to Disposition/Impairment of Assets". After an impairment is recognized, the reduced carrying amount of the asset shall be accounted for as its new cost. The new cost shall be depreciated over the asset's remaining useful life. Restoration of previously recognized impairment losses is prohibited.

All long-lived assets that the credit union plans to dispose of, whether by sale or abandonment, shall be reported at the lower of carrying amount or fair value less cost to sell. An example may be an obsolete building acquired in a merger. Once the asset is written down to fair value less cost to sell (if lower than carrying amount), it shall not be depreciated while it is held for disposal. Subsequent adjustments to the fair value less cost to sell may be made as long as the carrying amount of the asset does not exceed the carrying amount of the asset before the original adjustment was made to reflect the decision to dispose of the asset. The gain/loss will be recognized as a current operating expense, "Gain (Loss) Due to Disposition/Impairment of Assets".

FURNITURE AND EQUIPMENT

This account represents the cost of furniture, fixtures and equipment. The cost of furniture, fixtures, and equipment shall be amortized over the estimated useful life through periodic charges to depreciation expense using any of the generally accepted methods of depreciation, except the reverse sum-of-the-years digits method.

Charges for depreciation may be made monthly, quarterly, semiannually, or annually, at the option of the credit union, but as a minimum, should be recorded at the end of each regular share account dividend period. The depreciation may be recorded under either the unit or the composite-life basis of depreciation as described under "Allowance for Depreciation of Furniture and Equipment".

a) Under the unit basis of depreciation, each depreciable fixed asset is depreciated separately based on its estimated useful life less estimated salvage value. When an asset is disposed of, the cost should be eliminated from this account and the accumulated depreciation to date should be cleared (by debit) to "Allowance for Depreciation of Furniture and Equipment". The difference between the net carrying value of the asset (the cost less accumulated depreciation to date) and any proceeds of sale received for the asset will represent net gain or loss and should be recorded in "Gain (Loss) on Disposition of Assets". As long as an asset has a salvage or useful value, the depreciation credit to

"Allowance for Depreciation of Furniture and Equipment" may not result in the asset being carried on the credit union's books at less than \$1.

b) Under the Composite Method of depreciation, groups of similar fixed assets will be depreciated over their estimated average useful lives by periodic charges to expense and credits to "Allowance for Depreciation of Furniture and Equipment". When individual items of furniture and equipment are disposed of, this account should be credited for the cost of the assets retired and the same amount less proceeds received (if any) should be charged to the "Allowance for Depreciation of Furniture and Equipment". No gain or loss should be recognized in the accounts since the composite rates used contemplate that items in the groups will be retired both before and after the expiration of the estimated average useful life.

An exception may be made and gain or loss recognized under the procedure described in the foregoing paragraph when retirements are abnormal and are material in amount, since the composite rates do not anticipate such retirements. Also, under this depreciation method, the accumulated depreciation allowance account should never be permitted to exceed the fixed asset amount.

To simplify recordkeeping, furniture and equipment items costing less than a fixed amount (e.g., \$200) that is established by the board of directors should be expensed by a debit to "Other Office Operations Expenses" at the time of purchase.

Entries in the Journal and Cash Record

This account is debited in the "Miscellaneous-Debit" column with the cost of furniture and equipment purchased by the credit union. This account is credited in the "Miscellaneous-Credit" column with the cost of any items disposed of by sale or otherwise.

Posting to the General Ledger

Entries in this account are posted individually from the "Miscellaneous" columns of the Journal and Cash Record. Items recorded in this account

should be concisely identified in the "Explanatory Remarks" column. A memorandum notation should be made in the "Explanatory Remarks" column of any item disposed of so this account will provide a record of all furniture and equipment on hand.

Furniture and Equipment Acquired by Trade

In some cases when a new asset is purchased, the credit union will exchange or trade-in the current asset. This is common with computer equipment. Unless the book value and the fair market value are equal, the credit union must record a gain or loss on this exchange. This gain or loss should be computed as the difference between the fair market value and the book value of the equipment given up. When furniture and equipment are traded for a new item(s), the book value of the newly acquired asset is the fair market value of the asset traded plus the amount of cash paid or debt incurred. If, as a result of this accounting method, the carrying value of the new asset exceeds its reasonable market value, the board of directors should authorize an immediate depreciation charge against the new asset to reduce the carrying value to the asset's market value.

Gain or Loss in the Year of Sale of an Asset

If an asset is sold during the year, a gain or loss will occur unless the asset is sold for book value (the original cost less depreciation). In order to compute this gain or loss, the following steps should be followed:

- *Record depreciation up to date.* Since the asset was sold prior to yearend, it is necessary to allocate depreciation up to the date of sale.
- *Compute book value.* The book value is the original cost to the credit union, plus any additions to the asset that have not been expensed, less any depreciation taken to date. This amount is the book value.
- *Determine proceeds from the sale.* This is the amount received by the credit union for the sale of the asset. If the property is abandoned or given away, the proceeds will be zero. If property is received as a part of the sale, the

sale may be considered a trade-in. Trade-ins are covered further in this section.

- *Determine gain or loss.* If the proceeds from the sale are greater than the computed book value, the sale is a gain. The gain is the difference between the proceeds and the book value. If the proceeds from the sale is less than the computed book value, then the sale is a loss.

Illustrative Entries

- a) When furniture and equipment is acquired:

Dr.-Furniture and Equipment	\$500	
Cr.- Cash		\$500

- b) When furniture and equipment is depreciated:

Dr.-Depreciation of Furniture and Equipment	\$25	
Cr.-Allowance for Depreciation of Furniture and Equipment		\$25

- c) When furniture and equipment is sold at a loss, where unit basis of depreciation is followed. Assume an office machine sold for \$200; original cost of \$1,800; less accumulated depreciation to date of \$1,400.

Dr.-Cash	\$200	
Dr.-Allowance for Depreciation of Furniture and Equipment	1,400	
Dr.-Gain (Loss) Due to Disposition/Impairment of Assets	200	
Cr.-Furniture and Equipment		\$1,800

- d) When furniture and equipment is sold at a loss, where composite-life basis of depreciation is followed. Assume a typewriter sold for \$200; original cost of \$1,800 accumulated depreciation to date of \$1,400:

Dr.-Cash	\$200	
Dr.-Allowance for Depreciation of Furniture and Equipment	1,600	
Cr.-Furniture and Equipment		1,800

- e) When furniture and equipment is sold at a gain, where unit basis of depreciation is followed. Assume a typewriter sold for \$600; original cost of \$1,800; less accumulated depreciation to date of \$1,400.

Dr.-Cash	\$600	
Dr.-Allowance for Depreciation of Furniture and Equipment	1,400	
Cr.-Gain (Loss) Due to Disposition/Impairment Of Assets		\$200
Cr.-Furniture and Equipment		1,800

- f) When an asset is traded in for a new asset and a gain has occurred. Assume the credit union acquires a new typewriter for \$1,000 cash and the trade-in of an old typewriter. The original cost of the old typewriter is \$1,800 and accumulated depreciation to date is \$1,400. The book value of the old typewriter is \$400 and the fair market value is \$600.

Dr.-Furniture and Equipment (new)	1,600	
Dr.-Allowance for Depreciation of Furniture and Equipment	1,400	
Cr.-Gain (Loss) Due to Disposition/Impairment of Assets		\$200
Cr.-Furniture and Equipment (old)		1,800
Cr.-Cash		1,000

Detailed Transactions

Debit:

a) With cost of such assets purchased.

Credit:

a) With cost of such assets upon sale or other disposition.

Allowance for Depreciation of Furniture and Equipment

This account reflects the amount provided for depreciation or obsolescence of the respective assets. See description of "Furniture and Equipment" for a description of the unit and composite-life basis of depreciation as well as for the method to be followed when assets are disposed of under each such basis of depreciation. The balance of this account should be deducted from the balance of "Furniture and Equipment" when Statements of Financial Condition are prepared.

Illustrative entries for this allowance are described in the "Furniture and Equipment" section.

Outlined on the next page are acceptable depreciation ranges expressed as a lower limit, a generally accepted period, and an upper limit for certain types of assets.

The cost of furniture, fixtures and equipment shall be amortized over the estimated useful life through periodic charges to depreciation expense using any of the generally accepted methods of depreciation except the reverse sum-of-the-years digits method. The cost of computer software shall be amortized on a straight-line basis unless another basis is more representative of the software's use.

Sample Depreciation Methods

Straight Line

This method is the most popular among credit unions and the simplest to apply. Salvage value is deducted from the cost. The remaining amount is divided by the useful life of the asset, and that amount is the yearly depreciation expense. The amount of the depreciation will remain the same until the asset has been depreciated down to salvage value.

To illustrate this method, assume that the credit union purchases an asset for \$10,000 with a useful life of 5 years.

The estimated average value of the assets is \$1,000. The yearly depreciation would be \$1,800 computed as follows:

Cost of Asset:	\$10,000	
Less Salvage Value:	<u>1,000</u>	
Depreciable Amount:	<u>\$ 9,000</u>	
Depreciation, 20X1	\$1,800	(\$9,000/5 = \$1,800)
Depreciation, 20X2	\$1,800	(\$9,000/5 = \$1,800)
Depreciation, 20X3	\$1,800	(\$9,000/5 = \$1,800)
Depreciation, 20X4	\$1,800	(\$9,000/5 = \$1,800)
Depreciation, 20X5	\$1,800	(\$9,000/5 = \$1,800)

If an asset is purchased or sold during the year, it becomes necessary to expense only a portion of the yearly depreciation expense. To illustrate, assume that the above asset was purchased on October 1, 20X1. The amount of the expense for that first year would only be \$450 (\$1,800 x 3/12).

Instead of computing depreciation on a yearly basis, months can be substituted for years. Instead of computing a yearly depreciation rate, the credit union can compute a monthly rate by dividing the cost of the asset (less salvage value) by the number of months in the useful life. In the above example,

DEPRECIATION AMORTIZATION PERIODS

	Lower Limit	Generally Accepted Period	Upper Limit
Office Furniture, Fixtures & Equipment: Includes furniture, fixtures and equipment which are not a structural component of a building, i.e., desks, files, safes, and communication systems	8	10	12
Information Systems: Includes computers and their peripheral equipment used in administering normal business transactions and the maintenance of records, their retrieval and analysis	5	6	7
Data Handling Equipment Except Computers: Includes typewriters, calculators, accounting machines, Copiers, and other duplicating equipment, automated teller Machines, etc.	5	6	7
Computer Software Costs	5	5	5
Automobiles and Van	2.5	3	4
Buses	7	9	11
Light General Purpose Trucks (Less than 13,000 lbs.)	3	4	5
Heavy General Purpose Trucks	5	6	7
Land Improvements: Includes sidewalks, parking lot surfacing, drainage facilities, sewers, fences and landscaping shrubbery		20	

the monthly rate of depreciation would be \$150, (\$9,000 / 60 months = \$150).

Sum-of-Year-Digits

This method is designed to provide more depreciation expense in the first few years of ownership and less in the last few years. This is called an accelerated method of depreciation. It is most useful in leveling out expenses over the life of an asset. As an asset ages, repair and maintenance costs increase. An accelerated depreciation method

should provide high depreciation costs when repair costs are low and low depreciation costs when repair costs are high. Total costs for an asset (depreciation and repairs and maintenance) should then remain somewhat level over its useful life.

To compute depreciation under the sum of the years digits method, the cost of an asset (less salvage value) is multiplied by a fraction each year to determine that year's depreciation expense.

The denominator (bottom line) of this fraction is the sum of each of the years in the useful life of an asset. If the useful life of an asset is 3, then the sum of the years is 6 ($3 + 2 + 1$). If the useful life of an asset is 4, then the sum of the years is 10 ($4 + 3 + 2 + 1$). This part of the fraction will stay the same each year.

The numerator (top number) of this fraction is the number of years of useful life remaining for the asset. This part of the fraction will change each year.

Example 1: Assume a \$10,000 asset with a useful life of 5 years and a salvage value of \$1,000. The depreciation expense is computed as follows:

	Fraction Amount	Depreciable Amount	Depreciation Expense
Depreciation 20X1	5/15	\$9,000	\$3,000
Depreciation 20X2	4/15	\$9,000	2,400
Depreciation 20X3	3/15	\$9,000	1,800
Depreciation 20X4	2/15	\$9,000	1,200
Depreciation 20X4	1/15	\$9,000	600
Total Depreciation			<u><u>\$9,000</u></u>

The fractions for the following years are:

Year	4 Year Useful Life	5 Year Useful Life	6 Year Useful Life
1	4/10	5/15	6/21
2	3/10	4/15	5/21
3	2/10	3/15	4/21
4	1/10	2/15	3/21
5	--	1/15	2/21
6	--	--	1/21

Months (or quarters) may be substituted for years if the credit union elects to compute monthly (or quarterly) depreciation.

When a credit union computes depreciation on a yearly basis, it becomes necessary to record only a portion of that depreciation in the year of purchase and in the year of sale of the asset. This can be done by months or by days.

Assume that the credit union purchases an asset on April 1, 1981. The asset, cost \$12,500, has a salvage value of \$500 and a useful life of 3 years, and the credit union elects to use the sum of the years digits method of depreciation. Since the asset was purchased one-fourth of the way through the first year, only three-fourths of the depreciation should be taken in the first year, the remainder should be taken in the second year. Each additional year must also be allocated as well.

Year	Fraction	Depreciable Amount	Depreciable Expense
1	3/6	\$12,000	\$ 6,000
2	2/6	12,000	4,000
3	1/6	12,000	2,000
Total Depreciation Expense			<u>\$12,000</u>

Calendar Year	1981	1982	1983	1984
1st year $\frac{3}{4} \times 6,000$	4,500			
1st year $\frac{1}{4} \times 6,000$		1,500		
2nd year $\frac{3}{4} \times 4,000$		3,000		
2nd year $\frac{1}{4} \times 4,000$			1,000	
3rd year $\frac{3}{4} \times 2,000$			1,500	
3rd year $\frac{1}{4} \times 2,000$				500
Total Expense for Year	\$4,500	\$4,500	\$2,500	\$500

Declining Balance

This depreciation method is also an accelerated method of depreciation providing for additional depreciation expense in the early years. Under this method, a fixed percentage is multiplied by the declining balance of the particular asset. The rate of depreciation is a number between 100 and 200 percent of the straight-line rate. The following steps should be used to determine depreciation under the declining balance method.

Facts: The credit union purchased an asset for \$10,000 with a useful life of 5 years. The estimated salvage value of the asset is \$1,000.

a) Determine the straight-line rate:

The straight-line rate is determined by the following formula: 1 divided by the useful life of the asset. For example, an asset with a useful life of 5 years would have a straight-line rate of 20 percent.

b) Multiply the straight line rate by a percentage between 100 and 200:

Assume that a credit union wanted to use a rate of 150 percent of the straight-line rate. On an asset with a useful life of 5 years, then 150 percent of the straight-line rate would be 30 percent (1 divided by 5 has a straight-line rate of 20 percent, and 150% of that rate is 30 percent).

c) Multiply the depreciation rate times the declining balance of the asset (ignoring salvage value until the last year). To determine a years depreciation expense, multiply the depreciation rate times the declining balance (the original cost less prior years depreciation, if any). The declining value must never fall below the estimated salvage value of the asset. Also, in the last year of useful life, the asset must be written down to salvage value.

Purchased 1/1/X1	Depreciation	Balance
		\$10,000
Depreciation, 20X1 (\$10,000 x 30%)	\$3,000	7,000
Depreciation, 20X2 (\$ 7,000 x 30%)	2,100	4,900
Depreciation, 20X3 (\$ 4,900 x 30%)	1,470	3,430
Depreciation, 20X4 (\$ 3,430 x 30%)	1,029	2,401
Depreciation, 20X5 (Write-down to salvage value)	1,401	1,000
Total Depreciation	\$9,000	

In the event that an asset is purchased or sold during the year, only a portion of the year's expense should be recorded. In the above example, if the asset has been purchased on July 1, 20X1. The depreciation for the first year would be only \$1,500

(6/12 x \$3,000). In subsequent years, the credit union should continue to use the 30 percent rate against the declining balance to determine the depreciation expense for the year.

Comparison of Three Methods

	Straight-Line	Sum of the Year Digits	Declining Balance
Depreciation, 20X1	\$1,800	\$3,000	\$3,000
Depreciation, 20X2	1,800	2,400	2,100
Depreciation, 20X3	1,800	1,800	1,470
Depreciation, 20X4	1,800	1,200	1,029
Depreciation, 20X5	1,800	600	1,401
Total Depreciation	\$9,000	\$9,000	\$9,000

Composite Depreciation Method

This method allows economic lives to be applied to broad classes of assets rather than to detailed items of depreciable property. Composite or group depreciation is a process of averaging the economic lives of a number of property units and taking depreciation on the entire group as if it were a unit. The depreciation rate is computed determining the depreciation for 1 year for each item or each group of similar items and dividing the total depreciation thus obtained by the total cost or other basis of the assets. This average rate is to be used as long as

later additions, requirements, or replacements do not substantially alter the relative proportions of different types of assets in the accounts. An example of the computation of a composite rate under the straight-line method follows:

On January 2, a desk was bought for \$500. It has an estimated useful life of 10 years. A calculator was also purchased for \$500. The life was 5 years. Estimated salvage value was 20% of cost on both items. The average rate of depreciation is computed as follows:

Asset	Date Acquired	Original Cost	Estimated Salvage Value	Amount To Be Depreciated	Annual Economic Life	Annual Depreciation
Desk	1/2	\$ 500	\$100	\$400	10	\$ 40
Calculator	1/2	500	100	400	5	80
		<u>\$1,000</u>	<u>\$200</u>	<u>\$800</u>		<u>\$120</u>

(Average rate of depreciation (\$120 divided by \$1,000) = 12%)

LEASEHOLD IMPROVEMENTS

This account represents the cost to the credit union of leasehold improvements which are currently being used in connection with its operations. Leasehold improvements are improvements made to the lessor's property which is occupied or otherwise used by the lessee credit union under a lease or rental agreement. The leasehold improvements are paid by the credit union, but they revert to the lessor upon termination of the lease. Leasehold improvements frequently represent significant payments by the credit union, and for this reason, a separate asset account, "Leasehold Improvements", should be established for amortizing these improvements.

Leasehold improvements can arise when property has been leased and additions, improvements, or alterations are made to make the property more usable by the credit union. Funds expended by the credit union to improve or alter buildings provided for the credit union's use on military installations should be recorded as leasehold improvements. This account also may be charged with the cost of renovations (including repair and decoration costs) made when premises are initially occupied for the purpose of making the property usable by the credit union.

Leasehold improvements should be amortized over the period of the lease giving recognition to renewal options or the estimated life of the improvements, whichever period is the shorter. In the case of premises occupied without a formal lease, the amortization should be made over the estimated life of the improvements, unless the

directors have a definite basis for determining the period the credit union will occupy the premises. The amortization should be made over the life of the improvements or the estimated period of occupancy, whichever period is the shorter. This requirement is applicable unless the directors have a definite basis for determining the period that the credit union will occupy the premises.

The amortization of leasehold improvements should be made by charging the expense, "Amortization of Leasehold Improvements", and crediting "Allowance for Amortization of Leasehold Improvements". The latter account does not apply to funds expended to construct buildings on Department of Defense installations. Those funds need to be recorded in "Leased Assets Under Capital Lease".

If the credit union does not use the leasehold improvements or abandons the premises prior to complete amortization of leasehold improvements, the accumulated amortization to date should be cleared from "Leasehold Improvements" and "Allowance for Leasehold Improvements" and the difference charged to "Gain (Loss) on Disposition/Impairment of Assets".

Entries in the Journal and Cash Record

All entries debiting or crediting this account should be recorded in the "Miscellaneous" columns.

Illustrative Entries

- With the cost of leasehold improvements:

Dr.-Leasehold Improvements	\$15,000	
Cr.-Cash		\$15,000

b) With the capitalized value of leasehold improvements when the lease expires; assume \$15,000 cost of improvements and amortization previously recorded of \$15,000:

Dr.-Allowance for Amortization of Leasehold Improvements	\$15,000	
Cr.-Leasehold Improvements		\$15,000

c) If the leased premises are vacated by the credit union before the leasehold improvements are fully amortized; assume \$15,000 cost of improvements and amortization to date of \$12,000:

Dr.-Gain (Loss) on Disposition/ Impairment of Assets	\$ 3,000.00	
Dr.-Allowance for Amortization of Leasehold Improvements	12,000.00	
Cr.-Leasehold Improvements		\$15,000.00

Detailed Transactions

Debit:

a) With cost of leasehold improvements when incurred.

Credit:

a) With cost of leasehold improvements carried in this account upon termination of the lease, when the premises are vacated by the credit union, or when leasehold improvements are charged off for any other reason.

Allowance for Amortization of Leasehold Improvements

This account reflects the accumulated allowance for leasehold improvements. The balance of this account should be deducted from the balance of "Leasehold Improvements" when statements of financial condition are prepared.

Entries in the Journal and Cash Record

All entries affecting this account should be entered in the "Miscellaneous" columns of the Journal and Cash Record.

Detailed Transactions

Credit:

a) Periodically, with amount necessary to amortize the leasehold improvement asset account over the period of the lease, or the estimated value of the improvements, whichever is shorter.

Debit:

a) With amount of accumulated amortization upon termination of the lease or when leasehold improvements are charged off for any other reason.

NCUSIF DEPOSIT

INVESTMENT IN NCUA SHARE INSURANCE CAPITALIZATION FUND

This account is used to record deposits into and redistributions from the National Credit Union Share Insurance Fund (NCUSIF). The amount deposited or redistributed is based on the insured shares of a credit union on December 31. NCUSIF deposits normally equal 1% of a credit union's total insured shares. Invoices are provided to federally insured, state-chartered credit unions and federally chartered credit unions annually; for credit unions with \$50 million or more in assets, invoicing is semi-annually. These invoices itemize the amounts due to the NCUSIF. The invoice for federally chartered credit unions also includes the

computation of the amount due for the annual operating fee.

Illustrative Entries

- a) To record payment of the capitalization deposit adjustment or initial deposit:

Dr.-Investments in NCUSIF	\$1,595.67	
Cr.- Cash		\$1,595.67

- b) To record a redistribution of the NCUSIF equity, i.e., when a credit union's shares decrease from the preceding insurance year:

Dr.-Cash	\$75.00	
Cr.-Investments in NCUSIF		\$75.00

Detailed Transactions

Debit:

- a) With the amount of payments to the National Credit Union Share Insurance Fund.

Credit:

- a) With the amount of a redistribution of NCUSIF equity.

Reference: Rules and Regulations 741.4.

OTHER ASSETS

SERVICING ASSETS

When a credit union sells whole loans or participations in loans, the credit union often retains the right to service the loans. A credit union may also service credit card receivables or other financial assets. This asset category represents the economic value of these servicing rights. Further discussion of this topic is outside the scope of this manual. Credit unions involved in servicing loans or other assets should seek the guidance of an independent accountant.

ACCOUNTS RECEIVABLE

Receivable accounts are used to record claims of the federal credit union for money, goods, or services from other entities or persons. The primary "trade debtors' accounts" of a federal credit union are evidenced by loans to members and other notes and contracts receivable which are discussed in the "Loans" section of this manual.

Payroll Deductions Receivable

This account is used to record payroll receivables from members' employers prior to the credit union's receipt of the funds by check, magnetic or electronic media. A debit balance in this account indicates that an employer's payroll(s) was/were not received on the date(s) agreed upon by the employer and the credit union.

Illustrative Entries

Dr.-Payroll Deductions Receivable	\$25,000	
Cr.-Undistributed Payroll Deductions or Allotments		\$25,000

Detailed Transactions

Debit:

- a) With an estimated amount receivable from an employer that has not been received on the "set date."

Credit:

- a) With the similar amount when received from the employer.

Receivables From Officials And Employees

This account is used to record accounts receivable due from officials and employees of the credit union. This account is not used to record loans to members. Examples of receivables might include: travel advances outstanding while an employee is at the CUNA management school and issuance of a second (or duplicate) payroll check to an employee

after the employee reports that the first check was lost or misplaced.

Illustrative Entries

- a) To record a travel advance to an employee:

Dr.-Receivables from Officials and Employees	\$500	
Cr.-Cash		\$500

- b) To record the employee's claim for travel expenses and application of the advance:

Dr.-Employees' Travel And Conference Expenses	\$555	
Cr.-Receivables from Officials and Employees		\$500
Cr.-Cash		55

Detailed Transactions

Debit:

- a) With the amount of a travel advance to an employee attending a credit union related school or conference.

Credit

- a) With the actual expenses incurred by an employee attending a credit union related school or conference up to the amount advanced.

Insurance Premiums Receivable

This account is used to record the unpaid balance of amounts due from member-borrowers in payment of reimbursable premiums paid out by the credit union for insurance covering property accepted as security for loans and for life insurance protection (borrowers' protection insurance). Only insurance premiums advanced for which the credit union is to be reimbursed by the borrowers are to be recorded in this account.

This account is not to be used for insurance premiums advanced at the time a loan is made to a member. Such advances should be included as a part of the loan and the grand total set forth in the note. If members desire the credit union to advance such insurance premiums they should apply for a loan which should be processed in the same manner as all other loan applications are handled.

In those cases where it is agreed that the borrower shall provide such insurance and continue it in force during the period the loan is unpaid, it is suggested that a written agreement to this effect, containing an authorization for the credit union to advance the premium for continuing the insurance, be obtained at the time the loan is granted. This agreement may be included in the loan application, the lien instrument, or a separate contract. If interest is to be collected on such advances, provision for the interest should be made in the agreement. In the event the written agreement allows the credit union to add these premium advances to the borrowers' loan balance, the credit union should account for these advances in "Loans" rather than "Insurance Premiums Receivable". "Insurance Premiums Receivable" should also be used to record insurance premium advances made on outstanding "Notes and Contracts Receivable".

Since insurance on property accepted as security for loans is obtained primarily for the benefit of the borrower, it is appropriate to require the borrower to furnish such insurance. If he does not pay the premiums thereon when due, the credit union may advance such premiums, charge them to this account, and collect them later, by reimbursement from the borrower in accordance with an agreement.

Amounts charged to this account represent amounts due from borrowers which are advanced by the credit union to continue insurance coverage when the borrower does not pay the premium when they come due. These amounts should not be confused with funds collected, in advance by the credit union, for remittance to the insurance company for the borrower. Such amounts collected in advance are recorded in "Accounts Payable".

Entries in Journal and Cash Record

This account is debited in the "Miscellaneous Debit" column when a check is issued in payment of the insurance premium involved. This account is credited in the "Miscellaneous-Credit" column with the amounts of funds received from member/borrowers in payment of insurance premiums, and with the charge off of any uncollected items remaining after the related loans are either charged off or security repossessed.

The charge off of such items remaining in this account should be debited to "Miscellaneous Operating Expenses". Entries covering the charge off of insurance premiums receivable should be identified as such in the member's Individual Share and Loan Ledger accounts, and recoveries applicable to such items should be recorded in these accounts as memorandum information showing the amount recovered by the credit union, and the date the recovery was received.

Posting General Ledger

Each entry involving this account is posted individually to the General Ledger from the "Miscellaneous" columns of the Journal and Cash Record. The "Explanatory Remarks" column should show clearly the necessary dates of entries posted to this account such as the name of the individual from whom the amount is receivable. If separate columns are used in the Journal and Cash Record for entries to this account, the total amounts of these columns should be debited and credited respectively to the "Insurance Premiums Receivable" account in the General Ledger at the close of each month.

Posting to Subsidiary Ledger

If the number of these items necessitates a subsidiary ledger, a separate ledger sheet may be kept for each member involved. Appropriate headings identifying the account and person connected should be provided.

Debit entries for amounts received in payment of premiums due from borrowers are posted from Cash Received Vouchers to the Journal and Cash Record debit column of either the "Miscellaneous"

or "Insurance Premium Receivable" columns. Credit entries, such as uncollected amounts charged off, are posted from "Miscellaneous Credit" column or from the "Insurance Premiums Receivable" credit column of the Journal and Cash Record, whichever column is used by the credit union for credit entries to this account.

The total of the balances of the subsidiary accounts should equal the balance of the "Insurance Premiums Receivable" General Ledger Account and should be proved therewith at least monthly. The monthly lists of these balances should be retained as part of the credit union's records.

The credit union may find it advisable to make an entry in the "Memorandum" column of the borrower's individual loan ledger account in order to avoid the possibility of overlooking collection of these premiums from borrowers.

Illustrative Entries

- a) When a check is issued by the credit union in payment of an insurance premium that is reimbursable by the borrower:

Dr.-Insurance Premiums		
Receivable	\$50	
Cr.-Cash		\$50

- b) When the member-borrower reimburses the credit union for the insurance premium paid:

Dr.-Cash	\$50	
Cr.-Insurance Premiums		
Receivable		\$50

- c) When the insurance premium receivable is charged to the member's loan account:

Dr.-Loans	\$50	
Cr.-Insurance Premiums		
Receivable		\$50

Detailed Transactions

Debit:

a) With the issuance of a check in payment of an insurance premium that is reimbursable by the borrower.

Credit:

a) With a payment from the borrower to reimburse the credit union for the insurance premium paid.

b) With a charge of the premium payment to the member's share or loan account.

U.S. Savings Bonds Redeemed Receivable

Section 121 of the Federal Credit Union Act provides that federal credit unions may act as redemption or repurchase agents of the U.S. Treasury Department for the sale of U.S. Savings Bonds. Only those credit unions that have applied to the U.S. Treasury and have been approved as issuing and/or payment agents may engage in savings bonds transactions. Both members and nonmembers of the credit union can participate in these transactions.

This account should reflect amounts due from the U.S. Treasury for U.S. Savings Bonds redeemed. When payments are made to redeem bonds, the amounts disbursed should be debited to "U.S. Savings Bonds Redeemed Receivable". When remittances are received from the Federal Reserve Bank for the value of the bonds transmitted for reimbursement, this account should be credited. Refer to the "Cash and Cash Equivalents" section of this manual for further explanation and discussion relative to U.S. Savings Bonds.

Illustrative Entries

a) When U.S. Savings Bonds are redeemed by a member for cash or credit to shares:

Dr.-U.S. Savings Bonds Redeemed Receivable	\$19.75	
Cr.-Cash		\$19.75
or		

Cr.-Regular Shares	\$19.75
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b) When a remittance is received from the Federal Reserve Bank for the value of redeemed bonds and notes shipped:

Dr.-Cash	\$19.75	
Cr.-U.S. Savings Bonds Redeemed Receivable		\$19.75

Detailed Transactions

Debit:

a) With the payment made to a member for the redemption of a U.S. Savings Bond. The payment could be made from cash or recorded as a deposit to the member's share account.

Credit:

a) With a payment from the Federal Reserve Bank for the value of the redeemed savings bonds.

TIL Bond Claim Receivable

This account reflects the unpaid balance due the credit union for bond claims filed for losses incurred as the result of interest overcharges that were in excess of the provisions of Regulation Z.

Illustrative Entries

a) To record potential bond claim due to the credit union from the bonding company to achieve lump sum reimbursement for interest overcharges under Regulation Z:

Dr.-Truth in Lending Bond Claim Receivable	\$10,000	
Cr.-Shares		\$10,000
or		
Cr.-Cash		\$10,000

b) To clear the receivable account when the bond claim is paid, assuming the full amount has been received:

Dr.-Cash	\$10,000	
Cr.-Truth in Lending Bond Claim Receivable		\$10,000

Detailed Transactions

Debit:

a) With amounts due the credit union, from interest overcharges under Regulation Z.

Credit:

a) With amounts received in reimbursement of payments made by the credit union.

TIS Bond Claim Receivable

This account reflects the unpaid balance due the credit union for bond claims filed for losses incurred under the National Credit Union Administration Rules and Regulations, Part 707.

Illustrative Entries

a) To record potential bond claim due to the credit union from the bonding company:

Dr.-Truth in Savings Bond Claim Receivable	\$10,000	
Cr.-Shares		\$10,000

b) To clear the receivable account when the bond claim is paid, assuming the full amount has been received:

Dr.-Cash	\$10,000	
Cr.-Truth in Savings Bond Claim Receivable		\$10,000

Detailed Transactions

Debit:

a) With amounts due the credit union, from dividend underpayments, overpayments, and/or disclosure errors under Part 707.

Credit:

a) With amounts received in reimbursement of payments made by the credit union.

Other Accounts Receivable

This account reflects the unpaid balance due the credit union for miscellaneous accounts receivable for which no other specific General Ledger account is provided.

This account should include such items as amounts due from an insurance carrier when losses covered by the insurance are sustained; e.g., robbery, physical property damage, etc. The amount of losses should be charged to this account when incurred and the insurance carrier's reimbursement to the credit union should be credited to the account. Differences, if any, between the loss charged and the reimbursement amount should be written off to the proper expense classification.

This account also should include amounts due the credit union resulting from the sale of a fixed asset.

Illustrative Entries

a) When a miscellaneous account receivable is established representing property repair costs resulting from windstorm damage reimbursable by the insurance carrier:

Dr.-Other Accounts Receivable	\$300	
Cr.-Cash		\$300

b) When a check is received for loss reimbursement from an insurance carrier in the amount of \$275.00:

Dr.-Cash	\$275	
Dr.-Maintenance of Building	25	
Cr.-Other Accounts Receivable		\$300

Detailed Transactions

Debit:

- a) With each accounts receivable due the credit union for which no other specific General Ledger account is provided.

Credit:

- a) With payments received in liquidation of receivables charged to this account.
- b) With the write-off of uncollectible amounts charged to this account with the approval of the board of directors.

PREPAID EXPENSES AND DEFERRED CHARGES

Prepaid Rent

This account is used to record the prepayment of rent for space occupied by the credit union or for the rental of equipment. The account would also be used to record prepaid rent resulting from below market leasing costs under a sale-and-leaseback arrangement. For example, if the annual leaseback costs per the contract were \$225,000, but the annual market rental for the geographic area was \$450,000, \$225,000 would be recorded as prepaid rent and would receive periodic amortization.

Prepaid Share Insurance

This account represents the value of the unexpired portion of the share insurance premiums which should be charged to expense at a subsequent date.

Under Section 202(c) of the Federal Credit Union Act each insured credit union shall pay into the insurance fund, a premium charge equal to one-twelfth of one per centum of the total amount of the

insured shares in such credit union at the close of the preceding insurance year. Normally these premiums are payable in January each year for the insurance coverage for the entire calendar year. Often times, such share insurance premiums are waived by the NCUA Board.

Because of the relative size of this expense amount, credit unions may find it advantageous to prorate the cost over the period to which it applies. Such charges may be made monthly, quarterly, semiannually or annually at the option of credit unions using the Modified Cash basis of accounting. For credit unions using the accrual basis, the charges should be made monthly or, alternatively, at least quarterly or at the end of each regular share account dividend period.

Entries in the Journal and Cash Record

This account should be debited in the "Miscellaneous-Debit" column for the portion of applicable share insurance premiums which is to be amortized over the year and, therefore, not yet charged to expense. It should be credited in the "Miscellaneous Credit" column for the portion of the premium that is charged to expense.

Posting to the General Ledger

All entries in this account should be posted from the "Miscellaneous" columns of the Journal and Cash Record. Each entry should be explained in the "Explanatory Remarks" column of the General Ledger.

Illustrative Entries

- a) When the share insurance premium is paid and the current month's premium is charged to expense:

Dr.-Prepaid Share Insurance	\$220	
Dr.-Share Insurance	20	
Cr.-Cash		\$240

- b) An appropriate portion of premium is periodically charged to expense during the year:

Dr.-Share Insurance	\$20	
Cr.-Prepaid Share Insurance		\$20

Detailed Transactions**Debit:**

- a) With amount of share insurance premiums applicable to future periods.

Credit:

- a) With pro rata amounts of share insurance premiums charged to expense over the period to which the prepaid expense applies.

Other Prepaid Insurance

This account represents the value of the unexpired or prepaid portion of the surety bond and other insurance premiums, except share insurance.

Because of the savings involved, it may be advantageous to the credit union to purchase insurance coverage on more than a 1-year basis and charge the unexpired or prepaid portion of the premium to this account. Then periodic charges can be made to expense for the period to which the insurance is applicable. Such charges may be made monthly, quarterly, semiannually or annually.

A credit union which closes its books more than once a year and which pays substantial annual premiums for insurance, such as Chattel Lien Non-filing Insurance, may also use this account to allocate each month's costs as an expense item.

Borrowers' insurance premiums, life-savings insurance premiums and premiums advanced for members in connection with insurance on chattels which have been accepted as security for loans (see "Insurance Premiums Receivable" should not be charged to this account. Likewise, dividends received on borrowers' and life-savings insurance should not be recorded here.

Illustrative Entries

- a) A 3-year surety bond premium is paid; the current year's premium is charged to expense:

Dr.-Other Prepaid Insurance	\$200	
Dr.-Insurance	100	
Cr.-Cash		\$300

- b) Appropriate portion of premium is charged to expense during the second year:

Dr.-Insurance	\$100	
Cr.-Other Prepaid Insurance		\$100

Detailed Transactions**Debit:**

- a) With amount of other insurance premiums applicable to future periods.

Credit:

- a) With pro rata amounts of insurance premiums charged to cost over the period to which the prepaid expense applies.

Unamortized Organization Costs

The purpose of this account is to enable new credit unions to charge the cost of organization and original bookkeeping supplies to the expenses of more than one accounting period.

Use of Account

The "Unamortized Organization Costs" account may be debited with the costs of the credit union's organization and the cost of the original order for bookkeeping supplies. The cost should be debited to this account in every case except when they were donated to the credit union. When the supplies are donated, the cost is debited directly to "Miscellaneous Operating Expense" and the donation credited to "Other Nonoperating Income (Expenses)."

This account is an asset account and is shown as such on the Statement of Financial Condition of the credit union. At designated times to be determined by the board of directors, which may be monthly, quarterly, semiannually, or annually, charges to expense to reduce the amount set up as an asset are made as described below. In any event, the entire amount should be written off not later than the end of the second year following the year in which the credit union is chartered. It is recommended that the entire amount be written off as soon as it can be absorbed without appreciably affecting the earnings of the credit union.

Entries of Journal and Cash Record

Debit this account in the "Miscellaneous-Debit" column with the cost of the original order for bookkeeping supplies. Whenever it is decided to write off an amount, debit "Miscellaneous Operating Expenses" and credit this account as a "Miscellaneous-Credit".

Posting to General Ledger

Entries to this account are posted individually as "Miscellaneous" in the Journal and Cash Record.

Illustrative Entries

a) When the invoice is received for the original order for bookkeeping supplies, but the check is not issued in payment until a later date:

Dr.-Unamortized	
Organization Costs	\$620
Cr.-Other Accounts Payable	\$620

b) When any part of the entire amount of the Unamortized Organization Cost is written off:

Dr.-Miscellaneous	
Operating Expenses	\$12
Cr.-Unamortized Organization	
Costs	\$12

Detailed Transactions

Debit:

a) With the costs of organization and original bookkeeping supplies purchased at the time the credit union is organized.

Credit:

a) With the portion of the balance of this account when written off to expense.

Deferred Charges-Commitment Fees Paid in Connection with the Acquisition of Borrowed Funds

Commitment fees paid in connection with the acquisition of borrowed funds should be deferred. The treatment of the fees paid depends on the type of contract entered into and whether or not the commitment is exercised:

- If the commitment expires unexercised, the commitment fees paid should be expensed in "Unexercised Commitment Fees."
- If the borrowed funds will be repaid as a term loan, the commitment fees should be transferred to "Notes Payable-Commitment Fees" and amortized as interest on borrowed funds according to the interest method. See "Net Origination Fees (Costs)-Real Estate Loans Over 12 Years" for a detailed discussion of the interest method.
- If the credit union borrows funds under a revolving line of credit, the commitment fees should be amortized based on the straight-line method over the life of the contract. "Commitment Fees" should be used to record this expense.
- If the credit union pays all borrowings under a revolving line of credit and cannot reborrow under the contract, any unamortized fees should be expensed to "Commitment Fees."
- If the revolving line of credit contains an option to convert to a term loan, the fees should be amortized based on the straight-line method over the combined life of the line of credit and term loan. If the option is not exercised and all

borrowings are extinguished, any unamortized fees should be expensed.

- If the option to convert to a term loan is exercised, any unamortized fees would be transferred to “Notes Payable-Commitment Fees” and amortized as interest on borrowed funds using the interest method.

Illustrative Entries

- a) To defer commitment fees paid in connection with borrowed funds:

Dr.-Deferred Charges- Commitment Fees Paid in Connection With the Acquisition Of Borrowed Funds	\$2,200	
Cr.-Cash		\$2,200

- b) If the commitment expires unexercised:

Dr.-Unexercised Commitment Fees	\$2,200	
Cr.-Deferred Charges- Commitment Fees Paid in Connection With the Acquisition Of Borrowed Funds		\$2,200

- c) If the borrowed funds will be repaid as a term loan, related commitment fees should be periodically expensed as follows:

Dr.-Commitment Fees on Borrowed Money	\$200	
Cr.-Deferred Charges- Commitment Fees Paid in Connection With the Acquisition Of Borrowed Funds		\$200

- d) If the credit union borrows funds under a revolving line of credit and properly amortizes commitment fees using the straight-line method over the life of the contract:

Dr.-Commitment Fees on Borrowed Money	\$220	
Cr.-Deferred Charges- Commitment Fees Paid in Connection With the Acquisition Of Borrowed Funds		\$220

- e) If the credit union pays all borrowings under a revolving line of credit and cannot re-borrow under the contract, all related unamortized commitment fees should be expensed:

Dr.-Commitment Fees on Borrowed Money	\$2,000	
Cr.-Deferred Charges- Commitment Fees Paid in Connection With the Acquisition Of Borrowed Funds		\$2,000

- f) If the revolving line of credit contains an option to convert to a term loan, the fees should be amortized over the combined life of the line of credit and the term loan as in d. above. If the option is not exercised, any unamortized fees should be expensed as in e. above:

- g) If the option to convert to a term loan is exercised, deferred fees should be expensed as in c. above.

Detailed Transactions

Debit:

- a) With the amount of deferred commitment fees paid.

Credit:

- a) With the amount of the periodic amortization of commitment fees or write-off of unamortized commitment fees.

Deferred Pension Cost

This account consists of unamortized past service pension costs that are amortized for a period of not

less than 10 nor more than 40 years. A full discussion of pension plan accounting is beyond the scope of this Manual – seek the assistance of an independent accountant who can inform you concerning accounting rules under generally accepted accounting principles.

Other Prepaid Expenses and Deferred Charges

This account reflects the unamortized balance of prepaid expenses and deferred charges not specifically listed elsewhere which are to be allocated to subsequent operations.

This account is for use by credit unions following the modified cash basis of accounting as well as those following the accrual basis. Each credit union should determine the particular expense charges to be recorded in this account in order to spread the cost over the periods to be benefited. Examples of items which may be recorded as prepaid expenses or deferred charges include stationery and supplies, association fees, advances for accounting services, and the NCUA operating fee.

Subsidiary ledgers should be maintained for each prepaid and deferred expense reflecting the initial charge to the account, date, complete description of the expense, periodic amortization credits and balance remaining on each item. These subsidiary ledgers should be balanced to the General Ledger control account each month.

Entries in the Journal and Cash Record

Entries to establish prepaid expenses and deferred charges in this account should be recorded as "Miscellaneous-Debit". Entries to write off prepaid expenses and deferred charges should be credited to this account as a "Miscellaneous Credit; the offsetting debit to expense should be posted to "Operating Expenses (Control)", and numerical identification of the detailed expense account should be shown as "Account No."

Illustrative Entries

- a) To establish a prepaid expense or deferred charge for allocation to future period costs; e.g., if

stationery and supplies are purchased which will last for 3 years:

Dr.-Other Prepaid Expenses and Deferred Charges	\$360	
Cr.-Cash		\$360

- b) To prorate the expense applicable to each quarter year:

Dr.-Stationery and Supplies	\$30	
Cr.-Other Prepaid Expenses and Deferred Charges		\$30

Note: The cost recorded as other prepaid or deferred expenses may be prorated monthly, quarterly, or at the end of a regular share account dividend period.

Detailed Transactions

Debit:

- a) With charges paid or incurred which are to be allocated to future periods.

Credit:

- a) With the write-off of prepaid expenses and deferred charges to expense over the periods to which they apply.

INVESTMENTS IN AND LOANS TO CREDIT UNION SERVICE ORGANIZATIONS

These accounts are used to record investments in and loans to credit union service organizations (CUSOS) in accordance with Section 107(7)(I) and 107(5)(D), respectively, of the Federal Credit Union Act and Part 712 of the NCUA Rules and Regulations.

LOANS TO OTHER CREDIT UNIONS

This account should be used to record outstanding principal balances of all loans made to other credit unions in accordance with Section 107(7)(c) of the Federal Credit Union Act and Part 703 of NCUA's Rules and Regulations. The maximum investment in loans to other credit unions shall not exceed 25% of the investing credit union's paid in and unimpaired capital and surplus. A properly executed note of the borrowing credit union should be obtained at the time that the loan is made.

Entries in Journal and Cash Record

Debit this account as a "Miscellaneous-Debit" with the amount of new and renewal loans made to other credit unions. Credit this account as a "Miscellaneous-Credit" with the amounts received in part or in full payment of loans made to other credit unions; also, with the unpaid balance of such loans upon renewal.

Posting to General Ledger

Each entry involving this account is posted individually to the General Ledger as "Miscellaneous" in the Journal and Cash Record.

The names and addresses of credit unions to which loans are made should be clearly shown in "Explanatory Remarks" area of the General Ledger account. It is also desirable to show the terms of the loan, such as rate of interest and maturity date.

Subsidiary of General Ledger Account

When loans are made to two or more credit unions, it is recommended that subsidiary records be maintained to clearly identify transactions with each credit union. If subsidiary records are maintained, it should not be necessary to complete the "Explanatory Remarks" column of the General Ledger account.

Illustrative Entries

a) When a loan is made to another credit union, and a check is issued:

Dr.-Loans to Other Credit Unions	\$1,000	
Cr.-Cash		\$1,000

b) When the above loan to another credit union is repaid with interest:

Dr.-Cash	\$1,010	
Cr.-Loans to Other Credit Unions		\$1,000
Cr.-Income from Other Investments		10

c) When a loan to another credit union is partially paid and renewed at maturity of the loan:

Dr.-Cash	\$410	
Dr.-Loans to Other Credit Unions	600	
Cr.-Loans to Other Credit Unions		\$1,000
Cr.-Income from Other Investments		10

Detailed Transactions

Debit:

a) With principal amounts of loans made to other credit unions.

Credit:

a) With amounts of principal repayments received on loans to other credit unions.

ACCRUAL BASIS OF ACCOUNTING

Credit unions using the accrual basis should record income earned from these investments on a monthly basis, or alternatively, at least quarterly or at the end of each regular share dividend account period. The accrued income should be recorded by a debit to "Accrued Income from Investments". The entry to record interest received should consist of a debit to "Cash" and as a credit to "Accrued Income from Investments".

INSURANCE PREMIUM STABILIZATION RESERVE

This account may be used by those credit unions participating in risk rating plans for loan protection and life savings insurance. The account should reflect funds advanced to the insurance company or funds retained by the insurance company which would have otherwise been returned to the credit union as a dividend or refund of premium paid. The funds advanced to, or withheld by the insurance company, serve as a reserve from which claims will be paid when previous claims have exceeded a stated portion of premium payments.

Entries in the Journal and Cash Record

All entries affecting this account should be recorded in the "Miscellaneous" column of the Journal and Cash Record.

Illustrative Entries

- a) To record funds advanced to the insurance company in accordance with the risk rating plan contractual agreement:

Dr.-Insurance Premium	
Stabilization Reserve	\$1,000
Cr.-Cash	\$1,000

- b) To record a premium refund retained by the insurance company as a reserve for payment of claims:

Dr.-Insurance Premium	
Stabilization Reserve	\$500
Cr.-Members' Insurance	\$500

For another method of recording this transaction refer to the "Deferred Credit Insurance Premium Stabilization Reserve" account in Section 400 Liabilities.

- c) When the credit union is notified of excess claims paid by this insurance company and charged to the reserve:

Dr.-Members' Insurance	\$200
Cr.-Insurance Premium	
Stabilization Reserve	\$200

Detailed Transactions

Debit:

- a) With funds advanced to, or withheld from premium refunds by the insurance company.

Credit:

- a) When notified by the insurance company of excess claims paid and charged to the account.

ACCRUED INCOME

Accrued Income on NCUSIF Investment

This account should be used to record the redistribution (dividends) of NCUSIF equity to participating credit unions by the NCUA Board as necessary to reduce the NCUSIF to its normal operating level.

Note: Accruals should be recorded only after the NCUA Board declares a redistribution from the NCUSIF, not in anticipation of a declaration of dividends.

Illustrative Entries

- a) To record a declared redistribution from the NCUSIF:

Dr.-Accrued Income on	
NCUSIF Investment	\$450
Cr.-Income from Investment in	
NCUSIF	\$450

Reference Rules and Regulations, Part 741.4.

Other Accrued Income

This account is used to record earned income not otherwise provided for in other accrued income accounts. This account might be used for rental

income, income due from the sale of money orders, travelers checks, or other reimbursements for costs incurred for services that have been furnished to members.

This account should include the total amount of interest earned but not received for these miscellaneous items. This can be accomplished by debiting "Other Accrued Income" and crediting "Other Miscellaneous Operating Income" at the end of the month, quarter, or regular share account dividend period. On the following day (i.e., first day of the month), the accrual entry should be reversed by debiting "Other Miscellaneous Operating Income" and crediting "Other Accrued Income". As a preferable alternative to reversing this accrual entry, interest collected may be credited directly to "Other Accrued Income" until its balance reaches zero. Once this occurs, subsequent amounts received should be credited to "Other Miscellaneous Operating Income".

The illustrative entries and detailed transactions for this account will be similar to those previously outlined for "Accrued Income on Investments". Therefore, transactions and entries will not be repeated here.

OTHER ASSETS

This account is used to record transactions involving assets for which there is no specific asset account provided. Among the items which may be included in this account are:

- a) Deposits paid on safe deposit box keys or utility services.
- b) Collection and court costs advanced on loans.
- c) Property owned by the credit union for which no other account is provided.

Posting to General Ledger

Entries to this account are posted individually from the "Miscellaneous" in the Journal and Cash Record. Each entry should be adequately explained in the "Explanatory Remarks" area of the General Ledger account.

Detailed Transactions

Debit:

- a) With other assets to be entered in this account.

Credit:

- a) With amounts recorded in this account when collected or otherwise disposed of.

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LIABILITY ACCOUNTS

Every liability account should be supported by subsidiary ledgers for each payable item in the accounts. These subsidiary ledgers should reflect the initial credit to the account, date established, periodic debits and the remaining balance of each item in the particular General Ledger control accounts. These subsidiary ledgers need to be totaled and balanced to the respective General Ledger control accounts each month. For example, assume that "Accrued Expenses" has a month-end balance of \$4,300 due to the accrual of salary expense not yet paid and employee benefits not yet paid. The subsidiary ledger balance for "Accrued Salaries" totals \$2,600 and the subsidiary ledger for "Accrued Employee Benefits" (including sick leave, annual leave, etc.) total \$1,700. These subsidiary ledgers, when totaled, balance to the General Ledger control for "Accrued Expenses".

BORROWED FUNDS

NOTES PAYABLE

Notes Payable-Other

This account reflects the liability of the credit union for funds borrowed. Such borrowings must be in accordance with the Federal Credit Union Act.

Entries in the Journal and Cash Record

This account is credited as a "Miscellaneous-Credit" with the amount of notes payable which have been executed and delivered to creditors, including notes to other credit unions. The account is debited as a "Miscellaneous-Debit" when the liability is wholly or partially liquidated.

Posting to the General Ledger

The debit and credit items to this account entered as "Miscellaneous" in the Journal and Cash Record are posted individually to the General Ledger. Each note and any payments thereon should be specifically identified in the "Explanatory Remarks" column.

Subsidiary of General Ledger Account

If the credit union borrows funds from two or more sources, it should maintain subsidiary records that clearly identify transactions for each Note Payable. If subsidiary records are maintained, it will not be necessary to complete the "Explanatory Remarks" column of the General Ledger account.

Illustrative Entries

- a) When the credit union executes and delivers a note payable to others:

Dr.-Cash	\$3,000	
Cr.-Notes Payable-Other		\$3,000

- b) To record principal and interest payments made to liquidate notes payable:

Dr.-Notes Payable-Other	\$1,000	
Dr.-Interest on Borrowed Money	30	
Cr.-Cash		\$1,030

- c) When the credit union borrows money on its note and interest is deducted in advance by the creditor (1-year note at 10 percent):

Dr.-Cash	\$900	
Dr.- Interest on Borrowed Money	100	
Cr.- Notes Payable-Other		\$1,000

Detailed Transactions

Credit:

- a) With principal amounts of notes payable issued.

Debit:

- a) With principal repayments made to liquidate notes payable.

CERTIFICATES OF INDEBTEDNESS

PROMISSORY NOTES

Some credit unions borrow money from members or nonmembers and issue promissory notes, formerly called certificates of indebtedness or a similar name. Issuance of promissory notes is governed by Section 701.38 of the NCUA Rules and Regulations. The offering of promissory notes will necessitate the maintenance of a subsidiary ledger. If the note provides for payment of interest less frequently than the credit union's accounting period, consideration should be given to accruing the interest not less frequently than the end of each accounting period so that the cost of the borrowed money can be allocated to the periods during which the expense is incurred. The accruals should be recorded as "Accrued Interest Payable". Among the items to be considered for inclusion on the note are:

- Certificate number, pre-numbered for control purposes.
- Date of issue.
- Credit union name and location, and name and address of lender.
- Amount of the certificate or space to record the amount.
- Interest rate and method and time of payment of interest. Also, whether there would be any penalty for early redemption and whether interest will continue to accrue after maturity.
- Maturity date. Conditions for early redemption, including but not limited to where and how it may be redeemed.
- Provisions for signature of the treasurer and countersignature of the president.

Illustrative Entries

a) When the credit union executes and delivers a promissory note payable to others:

Dr.-Cash	\$25,000	
Cr.-Notes Payable- Promis- sory Note Payable		\$25,000

b) To record principal and interest payments made to liquidate a promissory note payable:

Dr.-Notes Payable- Promissory Note Pay- able	\$400	
Dr.-Interest on Borrowed Money	84	
Cr.-Cash		\$484

Detailed Transactions

Credit:

a) With principal amounts of promissory notes payable issued.

Debit:

a) With principal repayments made to liquidate promissory notes payable.

MORTGAGES PAYABLE

Mortgage Notes Payable

This account reflects the unpaid principal balance of mortgage loans owed by the credit union and secured by real estate owned by the credit union.

Upon acquisition of real estate, the amount of any mortgage loan should be recorded in this account. As periodic payments are made, this account should be debited for the principal amounts paid.

Entries in the Journal and Cash Record

All entries affecting this account should be entered as "Miscellaneous" in the Journal and Cash Record.

Illustrative Entries

a) When real estate is acquired subject to a mortgage loan. Assume the purchase of real estate for \$60,000, with land value at \$15,000, cash paid of \$20,000, and mortgage note payable of \$40,000:

Dr.-Land	\$15,000	
Dr.-Building	45,000	
Cr.-Cash		\$20,000
Cr.-Mortgage Notes Payable		40,000

b) When monthly payments are made in settlement of each mortgage installment:

Dr.-Interest on Borrowed Money	\$275.00	
Dr.-Mortgage Note Payable	83.33	
Cr.-Cash		\$358.33

Detailed Transactions

Credit:

a) With principal amount of mortgage notes payable when the liability is incurred.

Debit:

a) With amounts of principal payments to reduce (liquidate) the liability recorded in this account.

OBLIGATIONS UNDER CAPITAL LEASES

This account is used to record the liability that arises from a lease that is classified as a capital lease. In general, a lease that transfers substantially all the benefits and risks inherent in the ownership of property qualifies as a capital lease. Such leases should be accounted for by the lessee as the acquisition of an asset and the incurrence of a liability. For additional guidance and accounting procedures for "Capital Leases", consult an independent accountant.

FEDERAL FUNDS PAYABLE

Federal Funds Purchased

This account is used to record borrowed Federal Funds. Federal funds purchased generally consist of 1-day loans that are in the form of balances at (or checks drawn on) Federal Reserve banks. They are loans of superior money or bank reserves, as compared to the ordinary money or deposits at commercial banks. A credit union's management must be willing, however, to meet the interest rates determined each day by the Federal Funds market.

Total borrowings must not exceed 50 percent of the federal credit union's paid-in and unimpaired capital (Section 107(9) of the Federal Credit Union Act).

Entries in the Journal and Cash Record

This account is credited as "Miscellaneous-Credit" with the amount of notes payable which have been executed and delivered to creditors, including notes to other credit unions. The account is debited in as "Miscellaneous-Debit" when the liability is wholly or partially liquidated.

Posting to the General Ledger

The debit and credit items to this account entered as "Miscellaneous" in the Journal and Cash Record are posted individually to the General Ledger. Each borrowing and any payments thereon should be specifically identified in the "Explanatory Remarks".

Illustrative Entries

- a) To record borrowed Fed Funds:

Dr.-Cash	\$50,000	
Cr.-Fed Funds Payable		\$50,000

- b) To record the repayment of borrowed Fed Funds and one day's interest @ 10%:

Dr.-Fed Funds Payable	\$50,000.00	
Dr.-Other Interest on		
Borrowed Money	13.70	
Cr.-Cash		\$50,013.70

Detailed Transactions

Credit:

- a) With principal amounts of notes payable issued.

Debit:

- a) With principal repayments made to liquidate notes payable.

LETTERS OF CREDIT

Letters of credit (often referred to as "standby credits") are versatile instruments commonly used as a type of guarantee. They are often used in lieu of surety-ship contracts and arrangements that call for some guarantee of performance or payment. Further discussion of this topic is outside the scope of this manual. Credit unions involved in issuing letters of credit should seek the guidance of an independent accountant.

REVERSE REPURCHASE AGREEMENTS

Reverse repurchase agreements are agreements to sell and repurchase identical securities within a specified time at a specified price. This agreement represents an uninsured borrowing. Refer to the "Investments" section of this manual for further explanation and illustrative entries.

ACCRUED INTEREST PAYABLE

Accrued interest payable is often a significant liability in the financial statements of credit unions unless interest is paid on the financial statement date. Federal law and some state statutes, prohibit declaring interest until the end of the dividend period. A liability for interest earned by the share account holders should be recognized at each financial statement date.

Dividends Payable

Under Article XII, Dividends, of the standard Federal Credit Union Bylaws, the board of directors is authorized to establish dividend periods and declare dividends permitted by the Federal Credit Union Act, as amended. The dividend periods must be established so that the last dividend period in any calendar year ends on December 31, unless the cost of dividends is accrued by debiting "Dividends" and crediting "Accrued Dividends Payable". Dividends may be declared by the board for an established dividend period, from Earnings available after provision for reserves required by the Act and regulations, and after eliminating any existing deficit in Undivided Earnings. Dividends may be declared only during the last month of the dividend period or the first month following the close of the period. However, if the dividend period is monthly, dividends may be declared during the month. If the dividend period is more frequent than monthly, the board may declare the dividend during the previous month.

All dividend declarations shall include the establishment of a date on which such declared dividends will be distributed or posted to the accounts of the members.

Under the requirement that dividends be shown as an element of expense in Statements of Income, it is most important that dividends be recorded as current charges of the fiscal period to which they apply. Thus, when dividends are declared by the board during the first month following the close of the dividend period, they should be recorded as of the close of the applicable dividend period by a debit to "Dividends" and a credit to this account "Dividends Payable". Also, of course, dividends declared in the last month of the dividend period should be recorded in the same manner. The dividends will thus be shown on the Statement of Income prepared for the dividend period to which they apply.

When the dividends liability credited to this account is liquidated, this account should be debited and the offsetting credit should be to "Cash" or to the share accounts.

This account should be used only at the end of dividend periods to reflect the actual or estimated

amount of a dividend which is due and payable to the members. Credit unions which accrue dividend expenses on a more frequent basis than the actual dividend period should record the liability in "Accrued Dividends Payable". For example, a credit union which declares and pays quarterly dividends but accrues dividend expense monthly would record the liability in account "Accrued Dividends Payable" in between actual dividend periods. On financial statements for those months at the end of each dividend period (March, June, September and December) the liability should be transferred from account "Accrued Dividends Payable" to this account (Dividends Payable) in those cases where the dividend is not credited to members' accounts until the month following the end of the dividend period. Where the dividend is credited to members' accounts on the last day of the dividend period, the entry should be a debit to account "Accrued Dividends Payable" and a credit to "Shares" and the financial report for the end of the quarter should have no balance in either account "Dividends Payable" or account "Accrued Dividends Payable".

Entries in the Journal and Cash Record

All entries affecting these accounts should be recorded as "Miscellaneous" in the Journal and Cash Record.

Illustrative Entries

a) To record the estimated dividend liability for the months of July, August and September when the credit union is on a quarterly dividend period and dividends are credited to members' accounts on the first day of the next dividend period, assuming one class of shares. The following entries would be made at the end of each month:

Dr.-Dividend Expense	\$1,000	
Cr.-Accrued Dividends Payable		\$1,000

The balance of account "Accrued Dividends Payable" would then be \$3,000 at the end of September.

b) When the dividend is distributed to members' accounts on September 30, and the actual amount of the dividend is \$2,900:

Dr.-Accrued Dividends Payable	\$3,000	
Cr.-Shares		\$2,900
Cr.-Dividend Expense		100

c) Same example as (a.) above, except that dividends are credited to members' accounts on the first day following the end of the dividend period:

Entries for each month would be the same as (a.) above.

d) To record the dividend payable as of September 30 for example (c.) above:

Dr.-Accrued Dividends Payable	\$3,000	
Dr.-Dividends Payable		\$3,000

e) When dividend for (c.) and (d.) above is credited to members' accounts on October 1, and the actual dividend amounts to \$2,900:

Dr.-Dividends Payable	\$3,000	
Cr.-Shares		\$2,900
Cr.-Dividend Expense		100

Detailed Transactions

Credit:

- a) To record the amount of dividends either declared or estimated during an accounting period.
- b) With the excess of actual dividends, if any, over the amount previously recorded.

Debit:

- a) To liquidate the amount of dividend liability upon distribution to the shareholder.
- b) With the amount or difference, if any, between the accrued amount and the actual amount of dividends payable.

Dividend Calculation Methods

The dividend calculation method is the method by which dividends are determined. The NCUA R&Rs Part 707, *Truth In Savings*, allows two dividend calculation methods; 1) the daily balance method, and 2) the average daily balance method. Section 707.2(d) and (h), *Definitions*, defines both methods.

Examples of each method are provided using account activity for a month based on the "end of day" balance in the account. The dividend calculation must be based on a point in time for determining the balance in the account; such as "beginning of day balance", "end of day balance", and "close of business day balance".

Account Activity – Based on End of Day Balance

			BALANCE
Balance:	December 31, 20X4		\$1,000
Deposit:	January 1, 20X5	200	1,200
Withdrawal:	January 2, 20X5	100	1,100
Withdrawal:	January 10, 20X5	400	700
Deposit:	January 15, 20X5	200	900
Withdrawal:	January 16, 20X5	1,000	-100
Deposit:	January 18, 20X5	300	200
Deposit:	January 21, 20X5	700	900
Withdrawal:	January 31, 20X5	100	800

EXAMPLE 1

The daily balance method is the application of a daily dividend rate to the full amount of principal in the account each day. For the days the account is overdrawn, a zero balance should be used to calculate dividends.

Assume a dividend rate of 5.00%, a daily rate of $1/365$, a monthly compounding period, and a monthly crediting period. The daily dividend rate would be $.00013698630$ ($.05 \times (1/365)$). (See “Daily Rates” for the daily dividend rate formula). Dividends would be calculated as follows:

BALANCE x RATE x NUMBER OF DAYS

DIVIDEND AMOUNT

1/1/X5	\$1,200 x .00013698630 x	1	\$0.164383562
1/2/X5 to 1/9/X5	1,100 x .00013698630 x	8	1.205479452
1/10/X5 to 1/14/X5	700 x .00013698630 x	5	0.479452055
1/15/X5	900 x .00013698630 x	1	0.123287671
1/16/X5 to 1/17/X5	0 x .00013698630 x	2	0.000000000
1/18/X5 to 1/20/X5	200 x .00013698630 x	3	0.082191781
1/21/X5 to 1/30/X5	900 x .00013698630 x	10	1.232876712
1/31/X5	800 x .00013698630 x	1	0.109589041
TOTAL		31	3.397260274

For the month of January, 20X5, using the daily balance method to calculate dividends, a dividend amount of \$3.40 would be credited to the member's account. If the compounding period was daily, there would be 31 (the number of days in the compounding period) separate dividend calculations performed. The first day's accrued but uncredited dividends of \$0.164383562 would be considered in the second day's balance of \$1,100 (and every day's balance thereafter) to determine the second

day's dividend (and every day's dividend thereafter).

EXAMPLE 2:

The average daily balance method is the application of a periodic dividend rate to the average daily balance in the account for the period. The average daily balance is determined by adding the full amount of principal in the account for each day of

the period and dividing that figure by the number of days in the period.

Assume a dividend rate of 5.00%, a daily rate of 1/365, a monthly compounding period, and a

monthly crediting period. The periodic dividend rate would be .00424657534 $((.05*(1/365))*31)$. (See "Daily Rates" for the periodic dividend rate formula). Dividends would be calculated as follows:

BALANCE x NUMBER OF DAYS	ACCUMULATED BALANCE		
1/1/X5	\$1,200 x	1	\$1,200
1/2/X5 to 1/9/X5	1,100 x	8	8,800
1/10/X5 to 1/14/X5	700 x	5	3,500
1/15/X5	900 x	1	900
1/16/X5 to 1/17/X5	0 x	2	0
1/18/X5 to 1/20/X5	200 x	3	600
1/21/X5 to 1/30/X5	900 x	10	9,000
1/31/X5	800 x	1	800
TOTAL			<u>24,800</u>

Dividing the accumulated "end of day" balances of \$24,800 by 31 (the total number of days in the divi-

dend period), the average daily balance is \$800.00000.

The average daily balance should be rounded to five or more decimals. As an example, an average daily balance of \$800.12345678 would be rounded to no less than \$800.12346. The fifth decimal place should be rounded up if the sixth decimal place is five or more. The sixth decimal place of \$800.12345678 is a "6", thereby the fifth decimal place would be rounded up from "5" to "6".

The periodic dividend rate times the average daily balance results in a dividend amount of \$4.497260274. For the month of January, 20X5, using the average daily balance method to calculate dividends, a dividend amount of \$3.40 would be credited to the member's account.

If the compounding period was daily, there would be 31 (the number of days in the compounding period) separate dividend calculations performed. However, a daily dividend rate instead of the periodic dividend rate would be used to calculate each

day's dividend. The first day's accrued but uncredited dividends of \$0.109589041 $((.05*(1/365))*\$800)$ would be considered in the second day's average daily balance of \$800 (and every day's balance thereafter) to determine the second day's dividend (and every day's dividend thereafter). Although daily compounding is not commonly used when the average daily balance dividend calculation method is used, it is permissible. The NCUA R&Rs Part 707, *Truth In Savings*, allows any frequency of compounding to be used (regardless of the dividend calculation method used).

Dividend Periods

The dividend period is the span of time established by the board of directors at the end of which shares in a member's account earn dividend credit. In other words, a dividend period is the frequency with which accrued but uncredited dividends are earned by the member. As an example, assume dividend rates are declared quarterly and the board of directors has established the dividend period as monthly.

A member closing their account during the second month of the quarter would be entitled to the first month's accrued but uncredited dividends but not

to the second month's accrued but uncredited dividends. If the board of directors had established the dividend period as quarterly, the member would not be entitled to any accrued but uncredited dividends. Although a dividend period is commonly established at the same frequency with which dividends are credited or at the frequency with which dividend rates are declared by the board of directors, a dividend period may be at any frequency; i.e., daily, weekly, bi-weekly, monthly, semi-monthly, quarterly, semi-annually, annually, etc. The dividend period may be different for each type of share account but each type of share account must have a dividend period.

Dividend periods need not agree with calendar periods. As an example; a monthly dividend period could begin March 15 and end April 14. However, if the last dividend period in any calendar year does not end on December 31, the cost of the dividends accrued but uncredited must be reflected on the financial statements; by debiting "Dividends Expense" and crediting a payable.

Dividend Declaration Dates

The dividend declaration date is the date that the board of directors declares a dividend for the preceding dividend period. For credit unions with bi-monthly or longer dividend periods (such as quarterly, semiannually, or annually) the dividend rate must be determined: 1) during the last month of the dividend period, or 2) during the first month following the close of the dividend period. If the dividend rate is determined prior to the end of the dividend period (during the last month of the dividend period), the dividend rate is not declared but rather anticipated (projected or prospective) contingent upon current income and available earnings, after required transfers to statutory reserves. Upon the board of directors determining that current income and available earnings exist after required transfers to statutory reserves, the board of directors should ratify the dividend rate(s) (more than likely the anticipated (projected or prospective) dividend rate(s)). The day the dividend rate is ratified is the dividend declaration date.

If a credit union has established dividend periods which are monthly or more frequently (such as

daily or weekly dividend periods) the board of directors may determine the dividend rate: 1) during the preceding month, 2) during the last month of the dividend period, or 3) during the month following the month in which the dividend period(s) ended. Again, if the dividend rate is determined prior to the end of the dividend period (during the preceding month or during the last month of the dividend period), the dividend rate is not declared but rather anticipated (projected or prospective) contingent upon current income and available earnings, after required transfers to statutory reserves. The board of directors must ratify a dividend rate once current income and available earnings, after required transfers to statutory reserves, are determined to exist.

An anticipated (projected or prospective) dividend rate contingent upon current income and available earnings after required transfers to statutory reserves should be disclosed as such and not as the dividend rate for the last dividend declaration date.

If the board of directors does not declare a dividend for certain dividend periods (perhaps because of the lack of sufficient earnings), it may not, at a later date, declare a dividend for the dividend periods missed. Alternatives in this situation might be to establish a lengthier dividend period (by a change-in-terms notice under Section 707.5(a)) in anticipation that sufficient earnings could be generated to pay a dividend for the extended dividend period or to declare an extraordinary dividend. Extraordinary dividends are most commonly referred to as "bonus dividends". NCUA R&Rs Part 707.2(m), *Definitions*, defines *extraordinary dividends* as a non-repetitive dividend paid at an irregular time from funds legally available for such distribution.

Compounding Periods

The compounding period is the frequency that earned dividends are added to the principal in the account on which dividends then accrue. The compounding period can be based on any frequency; i.e., daily (a.k.a. "continuously"), weekly, bi-weekly, monthly, semi-monthly, quarterly, semi-annually, annually, none ("no compounding" or "at maturity"), etc. The compounding period may be different for each type of share account but each

type of share account must have a compounding period.

Crediting Periods

The crediting period is the frequency that earned dividends are posted or paid to the account, or provided to the member by check or transfer to another account. The crediting period can be based on any frequency; i.e., daily, weekly, bi-weekly, monthly, semi-monthly, quarterly, semi-annually, annually, at maturity, etc. The crediting period may be different for each type of share account but each type of share account must have a crediting period. Only declared dividends may be posted to an account, not anticipated (projected or prospective) dividends.

Dividend Distribution Dates

The dividend distribution date is the date the dividend is made available by credit to the account, or provided to the member by check or transfer to another account. The dividend distribution date for non-term share accounts is usually the last day of or the day following the crediting period. As an example, if the crediting period is monthly, January 31st could be the dividend distribution date (last day of) or February 1st could be the dividend distribution date (the day following). For term share accounts, the dividend distribution date may be on the anniversary dates (such as the 17th of each month). The dividend distribution date may be different for each type of share account but each type of share account must have a dividend distribution date. Regardless of the dividend distribution date, the date dividends are posted or paid is the date dividends must be available to the members. As an example, a dividend cannot be posted to a member's account on December 31st if it cannot be withdrawn until January 1st.

Daily Rates

Permissible daily rates for a 365-day year are 1/360 and 1/365. Permissible daily rates for a 366-day year (leap year) are 1/360, 1/365, and 1/366. If a daily rate of 1/366 is used, the account must earn dividends for February 29. The daily rate may be different for each type of share account but each type of share account must have a daily rate. The daily rate is used in the daily dividend rate formula, the periodic rate formula, and the periodic dividend rate formula. Each formula is as follows:

Daily Dividend Rate = Daily Rate x Nominal Rate
 Periodic Rate = Daily Rate x Number of Days in the Compounding Period.

Periodic Dividend Rate = Periodic Rate (Daily Rate = Number of Days in the Compounding Period) x Nominal Rate

The nominal rate is the dividend rate (expressed as a percent) divided by 100 or the dividend rate expressed as a decimal. As an example, the nominal rate is .0525 for a dividend rate of 5.25%.

A credit union should round the daily rate to five or more decimals. A 1/365 daily rate of .002739726 would be rounded to no less than .00274. The fifth decimal place should be rounded up if the sixth decimal place is five or more. The sixth decimal place of .002739726 is a "9", thereby the fifth decimal place would be rounded up from "3" to "4".

Dividend Credit Determination Dates (When a Share Purchase Begins Earning Dividend Credit)

The dividend credit determination date is the date dividends begin to accrue. Section 707.7(c) of the NCUA Rules and Regulations requires dividends to begin accruing no later than the day specified in section 606 of the *Expedited Funds Availability Act* and its implementing *Regulation CC*. Therefore, a credit union could use either the collected balance method or the ledger balance method.

An illustration of the collected balance method is as follows: Assume a member makes a \$5,100 non local check deposit on April 7, 20X5. When the collected balance method is used to accrue or pay

dividends, the time frames as to when funds are available for withdrawal by the member are different than the time frames for accruing dividends. Based on the availability for withdrawal by the member, the first \$100 must be made available the next day (April 8, 20X5). At least \$4,900 must be made available no later than the fifth business day following the banking day on which funds were deposited (April 12, 20X5). Due to the deposit being over \$5,000 (a large deposit) an extension of up to six business days (April 18, 20X5) may be placed on the remaining \$100. See *Regulation CC, Notice of Exception*, if no longer extensions are allowed by the credit union's policy.

Section 229.14, *Payment of Interest in Regulation CC* requires dividends to begin accruing on dividend-bearing accounts no later than the day on which the credit union receives credit for the funds deposited. It may be difficult for a credit union to track which day it receives credit for specific checks in order to accrue dividends properly on the account to which the check is deposited. Therefore, for the purpose of the dividend-accrual requirement, a credit union may rely on an availability schedule from its correspondent to determine when it receives credit. As an example, if a credit union receives credit on 20 percent of the funds deposited in the credit union by check as of the business day of deposit, 70 percent as of the business day following deposit, and 10 percent on the second business day following deposit, the credit union can apply these percentages to determine the day dividends must begin to accrue on check deposits to all dividend-bearing accounts.

An illustration of the ledger balance method is as follows: dividends would begin to accrue on the full \$5,100 the date of deposit (April 7, 20X5). Assume the board of directors established that dividends would be accrued and paid based on a "close of business day" balance, i.e., 3:00 p.m. If the deposit was made after 3:00 p.m., dividends would begin to accrue on the full \$5,100 the day following the date of deposit (April 8, 20X5).

Dividends must begin to accrue on payroll deductions share deposits when the member is entitled to receive the funds. When a credit union receives the detailed distribution of share payments, a member's

account must be credited immediately and dividends begin to accrue. If a crediting delay occurs for any reason other than not having the detailed distribution of share payments, the credit union should ensure dividends begin to accrue based on when the member was entitled to receive the funds.

Minimum Balances Associated With Dividends

A minimum balance can be required before an account earns dividends. The method used to determine the minimum balance to earn dividends must be the same method used to determine the balance on which dividends are calculated. As an example, if the daily balance method is used to determine dividends, then the daily balance method must also be used to determine the minimum balance. An alternative method may be used if it is unequivocally beneficial to the member. As an example, a credit union using the daily balance method to calculate dividends and requiring a \$500 minimum daily balance could choose to pay dividends on the account for those days of the month that did not meet the \$500 minimum daily balance provided the member maintained an average daily balance throughout the month of \$400. Other minimum balance requirements, such as to open an account, to avoid a fee, etc., can be based on any method.

Section 707.7, *Payment of Dividends*, identifies several restrictions regarding minimum balances to earn dividends:

- A credit union cannot require that both a daily minimum balance and an average daily balance be maintained to earn dividends.
- A credit union cannot pay dividends only on the balance portion over the minimum balance. As an example, if the member has \$500 and the required minimum balance is \$200, dividends cannot be paid only on \$300 (the amount over the minimum balance of \$200).
- A credit union cannot require a minimum balance to be maintained for the entire period to earn dividends for that period.

Dividend Reductions and Penalties

Penalties may be issued by the board of directors according to its prescribed policies. The board of directors may impose a penalty on any share account or term share account for failure of the member to comply with any terms or conditions of the account. One of the most common penalties used is the early withdrawal penalty. An early withdrawal penalty can be assessed when the member withdraws his/her funds from an account prior to the account's maturity. There are no requirements as to the method in which an early withdrawal penalty can be determined. The most commonly used early withdrawal penalties are: 1) the forfeiture of accrued dividends, or 2) a percentage of the amount withdrawn. NCUA R&Rs Part 707, also considers a withdrawal of some funds to trigger a change in the account's dividend rate and APY that is paid, or a change in the compounding or crediting frequency that those terms must be disclosed as early withdrawal penalties.

Early withdrawal penalties are most often associated with term share accounts. Term share accounts are most commonly referred to as "share certificates" or "certificates of deposit". Section 707.2(x), *Definitions*, defines term share accounts as being any share certificate, certificate of deposit, or other account with a maturity of at least seven days in which the member generally does not have the right to make withdrawals for six days after the account is opened, or the account is subject to an early withdrawal penalty of at least seven days dividends on amounts withdrawn. A term share account could also include a club account; such as Christmas Club Account, Vacation Club Account, Youth Club Account, etc. If the terms of the club account meet the definition of a term share account (even if the account does not have a stated maturity but instead has a disbursement date), the club account must be treated as a term share account. Any early withdrawal penalties must be disclosed as such, and subsequent disclosure requirements would have to be followed.

Dividend Entitlement on Closed Accounts

NCUA R&Rs Part 707, *Truth In Savings*, permits accrued but uncredited dividends to be forfeited if the account is closed. If this is permitted by the

credit union's policy, Section 707.4, *Account Disclosures*, requires the forfeiture of dividends to be disclosed.

Members who close their accounts prior to the dividend distribution date (or the end of the crediting period) are entitled to dividends up until the end of the last dividend period. However, the credit union may delay the payment of these dividends until the scheduled dividend distribution date. The following examples are based on dividend periods which are monthly or more frequently. (See "Dividend Declaration Dates" for determining dividend rates (anticipated (projected or prospective) or declared) based on the length of the dividend period). Example 1 typifies the situation when the dividend rate is anticipated (projected or prospective) during the preceding month and would be ratified by the board of directors at the close of the dividend period contingent upon current income and available earnings, after required transfers to statutory reserves. Example 2 typifies the situation when the dividend rate is declared during the month following the month in which the dividend period ended.

EXAMPLE 1:

Assume the board of directors credits dividends monthly and the dividend period is semimonthly. The dividend rate for the semi-monthly periods are anticipated (projected or prospective) during the preceding month. If a member closes his/her account on January 22, 20X5, he/she would be entitled to dividends for 7 days (the days after the last dividend period of January 15, 20X5). On January 22, the amount of dividends due this former member may be paid to him/her, or remain (in the form of a credit union liability) as a dividend payable to a former member. Since the dividend rate is anticipated (projected or prospective) in the preceding month it may, with proper wording in the account disclosures, be posted to the account at the time the account is closed. When the dividend rate is anticipated (projected or prospective) in the preceding month, the credit union's policy should require that written projections be on file to illustrate the existence of current income, undivided earnings, and required transfers to reserves to the end of the month for which the dividend rate is anticipated

(projected or prospective). This is necessary to comply with the provision for the required transfers to statutory reserves. In other words, the projected information will support that funds are/will be available to meet the reserve transfer requirement and pay the anticipated (projected or prospective) dividend (that which the board of directors will ratify at the close of the dividend period); closing the books prior to the dividend distribution date will fulfill the “projection” requirement.

EXAMPLE 2:

Assume the board of directors credits dividends quarterly and the dividend period is monthly. The dividend rate for the monthly periods are declared during the month (on the 5th) following the month in which the dividend period(s) ended. If a member on January 22, 19X5 closes his/her account of \$5,000 with accrued but uncredited dividends of \$15.07, on January 22 the credit union can disburse the member’s principal of \$5,000, but cannot post or disburse the accrued but uncredited dividends of \$15.07 until the board of directors declares on February 5th the dividend rate for the month of January.

No dividend can be paid in excess of available current income and prior earnings without the written approval of the NCUA Board.

Withdrawal of Funds

Dividends must accrue up to the day funds are withdrawn. As an example, assume dividends are accrued and paid based on the ledger balance method and the “end of day” balance. (See “Dividend Credit Determination Date” for discussion on the ledger balance method). The ending balance of January 1, 20X5 is \$1,000. A withdrawal of \$500 is made on January 5, 20X5, a deposit of \$200 is made on January 7, 20X5, and no other withdrawals or deposits are made for the month. Dividends must be accrued on \$1,000 from January 1, 20X5 to January 4, 20X5 (4 days), on \$500 from January 5, 20X5 to January 6, 20X5 (2 days), and on \$700 from January 7, 20X5 to January 31, 20X5 (25 days).

Instead, assume the member closed the account on January 10, 20X5 and accrued but uncredited dividends are not forfeited. Dividends would accrue the same as above up until January 6, 20X5. From January 7, 20X5 to January 9, 20X5 (3 days) dividends would accrue on \$700. Also, the average daily balance used in the APYE formula would be based only on the number of days the account was open (9 days).

Dividend Accrual

Whenever a dividend rate on any type of account is specified in advance (whether the dividend rate is as of the last dividend declaration date or an anticipated (projected or prospective) dividend rate for non-term share accounts, or within the most recent seven calendar days for term share accounts), dividend expense should be accrued monthly or at the end of the shortest dividend period if all dividend periods are longer than monthly. Dividend accruals may be based on either the collected balance method or the ledger balance method. Illustrations of the collected balance method and ledger balance are contained in “Dividend Credit Determination Dates”. The balance method used in dividend accruals should be the balance method used in paying dividends. If the collected balance method is used, see “*Dividend Period Length Versus Statement Period Length for the APYE*” for information regarding the average daily balance used in the APYE formula.

Term Share Account Dividend Rate

A federal credit union may make, in advance, an agreement to pay a specific dividend rate on a term share account. Since a federal credit union cannot honor a dividend rate promised in advance if current income and available earnings are insufficient, it is recommended that officials exercise extreme caution before making an agreement to pay a specific dividend rate. Any agreed upon rate should be evidenced by a signed written contract between the federal credit union and the member.

Agreeing to pay a dividend rate which cannot be met can cause members to lose faith in their credit union as well as civil liability for implied contracts. When credibility is lost, an outflow of shares is

almost a certainty. For this reason, it is recommended that agreed upon dividend rates be restricted to term share accounts. Advance agreement for a dividend rate does not eliminate the need for a formal declaration of dividends by the board of directors.

Determining Maximum Dividend Rate

The maximum dividend rate can be determined by:

- a. Dividing the amount available for dividends by the total shares for all members that are eligible for the dividend amount; then
- b. Multiplying the above result by the number of periods in a year. The number of periods in a year are determined by the number of periods the dividend amount is available for, i.e., a month, a quarter, etc.

As an example, assume the amount available for dividends for the period is \$3,280. The total of shares for all members that are eligible for the \$3,280 dividend amount is \$384,000. Dividing \$3,280 by \$384,000 equals .008541667. Multiply .008541667 by 12 (if the period is monthly) and by 4 (if the period is quarterly) to determine the maximum dividend rate. The maximum dividend rate which would be paid for a monthly period is 10.25% annually and for a quarterly period is 3.42%.

Methods of Distribution and Use of Dividend Record for Hand Posted Credit Unions

Credit of dividends to the share accounts of the members: Under this method the amount need not be entered in "Posted to Share Ledger" column of the *Dividend Record* form since a record of the amount has already been entered in the "Amt. of Dividend" column. A check mark is placed in the "Posted to Shares Ledger" column as each share account is posted for the dividend. A check mark or the poster's initials should also be placed in the "Posted to Passbook" column when the amounts are posted to the passbooks of the members. This column should be left blank by those credit unions using statements of account in lieu of passbooks. The last column shows passbooks in which dividends have not been recorded.

The date reflecting the posting to the individual account and the passbooks should be the date on which the dividend is payable. This date is established by the board of directors.

Payment by individual check to each member: The name of the member is entered in the "Name" column of the *Dividend Record* form and the number of each check issued in the "Number" column under the "Payment by Check" section. The amount of each check need not be entered unless dividends are paid to some members by check and to others by credit to shares. The return of checks by the bank when paid may be noted in the "Check Mark" column of the Record. If dividends are paid by check to each member, no entries are made in the Individual Share Loan Ledgers and the passbooks or statements of account.

Payment may not be made in cash or by drawing one check for the entire amount and disbursing the amounts due members in cash.

Payment in part by check and in part by credit to share accounts of the members: This procedure may be followed, for example, when the credit union desires to avoid writing checks of less than \$1.00 and therefore decides to credit all dividends of less than \$1.00 to the share accounts and to issue individual checks to members for dividends of \$1.00 or more. When this procedure is followed, the member's name is entered in the "Name" column of the *Dividend Record* for each check issued. The check number and the amount of each check are entered in the "Number" and "Amount" columns, respectively. When the credits to shares are posted to the members' accounts in the Individual Share and Loan Ledger as of the date established by the directors, the amounts are checked in the "Check Mark" column.

As indicated for the first method, the "Posted to Passbook" column is either initialed or checked when the members passbook is posted, as of the established date, with the amount of the dividend credited to shares. The total of the "Amount" column in the "Payment by Check" section and the amounts in the "Posted to Shares Ledger" column

should agree with the total of the “Amt. of Dividend” column.

Reporting Dividends to Internal Revenue Service

The required forms to report dividends paid and some bonuses to members on non-term share accounts and term share accounts are available from the Internal Revenue Service or a local supplier. Any questions about the reporting requirements or procedures should be directed to the local Director of Internal Revenue.

Annual Percentage Yield (APY)

NCUA R&Rs Appendix A, Part I of Part 707, *Truth In Savings*, provides the APY formula that is to be used in account disclosures and for advertising purposes. The APY is based on a hypothetical situation and does not take into consideration fluctuations during the period, such as deposits and withdrawals.

Dividend Formulas in Determining Dividends Using the APY Calculation

There are two simple dividend formulas that can be used to determine dividends on an account. These two formulas should provide the same result as a credit union’s automated system. The formulas and examples of dividend calculations are provided to assist in calculating the APY.

FORMULA 1:

Dividends = Principal * [(1 + Nominal Rate/Compounding Period)^(Compounding Periods in Term) - 1]

- *Nominal rate* is determined by dividing the dividend rate (not expressed as a percent) by 100 or the dividend rate expressed as a decimal.
- *Compounding Period* stands for compounding period. Use the following based on the compounding period: Daily - 360, 365, and 366 in a leap year if dividends will be earned February 29; Weekly - 52; Bi-Weekly - 26; Semi-Monthly - 24;

Monthly - 12; Quarterly - 4; Semi-annually - 2; Annually - 1.

- *Compounding Periods in Term* stands for compounding periods in term. If a daily compounding period is used; the term is expressed in the number of days. If a compounding period other than daily is used, the term is expressed as the same number that was expressed for the compounding period: Weekly - 52; Bi-Weekly - 26; Semi-Monthly - 24; Monthly - 12; Quarterly - 4; Semi-annually - 2; Annually - 1.
- *Principal* is the amount of funds assumed to have been deposited at the beginning of the account.

FORMULA 2:

Dividends = Principal * Daily Dividend Rate * Days in Term

- *Principal* is the amount of funds assumed to have been deposited at the beginning of the account.
- *Daily Dividend Rate* is the nominal rate (dividend rate (not expressed as a percent) divided by 100 or the dividend rate expressed as a decimal) times the daily rate of 1/360, 1/365, or 1/366 for a 366 day year (leap years) if the account will earn dividends for February 29th. A daily rate of 1/360 has to be applied to 365 days a year and 366 days a year for leap years.
- *Days in Term* is the number of days in the compounding period.

Examples of Dividend Calculations in Determining Dividends Used in the APY Calculation

The dividend amounts from the examples provided in this section have been used in the APY calculation examples provided in “APY Calculation”. The dividend calculation examples are based on a non-term share account and a term share account.

EXAMPLE 1 - Using Dividend Calculation Formula 1:

Assume the account is a non-term share account; a regular share account with no stated maturity. Principal is \$1,000. The credit union compounds

monthly. The dividend rate is 5.00%. The daily rate is $1/365$. Placing the numbers in Formula 1 of the dividend calculation, the dividend amount for the year is \$51.16190. (See “*APY Calculation for a Non-Term Share Account*” for the APY calculation).

$$\text{Dividends} = \text{Principal} * [(1 + \text{Nominal Rate}/\text{Compounding Period})^{(\text{Compounding Periods in Term})} - 1]$$

Step 1:	5.00 divided by 100	Result:	.05
Step 2:	.05 divided by 12	Result:	.004166667
Step 3:	.004166667 plus 1	Result:	1.004166667
Step 4:	1.004166667 raised to the exponent of 12	Result:	1.051161898
Step 5:	1.051161898 minus 1	Result:	.051161898
Step 6:	.051161898 times \$1,000	Result:	\$51.161898
Step 7:	Round \$51.161898	Result:	\$51.16190

(See “Rounding Rules for Dividends Used in the APY Calculation” for rounding rules for the dividend amount).

Formula 2 of the dividend calculation method could also be used for this example. However, to calculate the yearly dividend amount, the dividend amount for each compounding period in a year will have to be calculated. In this example, the number of compounding periods in a year is 12. Therefore, the dividend amount will have to be calculated 12 times. Each dividend amount will need to be added to the principal to arrive at the next month’s principal. If two conditions are met, the APY calculation based on a single compounding period could be used. (See “Short-Cuts to the APY Calculation”, Short-Cut Illustration 2).

EXAMPLE 2 - Using Dividend Calculation Formula 2:

Assume the account is a term share account; a 6 month share certificate for \$1,000. The credit union compounds monthly. The actual number of days in the share certificate is 184 (from March 1, 19X5 to August 31, 20X5). The number of days for any actual sequence of 6 months ranges from 181 to 184. The dividend rate is 5.00%. The daily rate is $1/365$. Placing the numbers in Formula 2 of the dividend calculation, the dividend amount for the year is \$25.47167. (See “*APY Calculation for a Term Share Account*” for the APY calculation).

Dividends = Principal * Daily Dividend Rate * Days in Term

Month of March, 20X5

Step 1:	5.00 divided by 100	Result:	.05
Step 2:	.05 times 1/365	Result:	.000136986
Step 3:	.000136986 times 31	Result:	.004246575
Step 4:	.004246575 times \$1,000	Result:	\$4.246575342
Step 5:	Round \$4.246575342	Result:	\$4.24658
Step 6:	\$4.24658 plus \$1,000	Result:	\$1,004.24658

Month of April, 20X5

Step 1:	5.00 divided by 100	Result:	.05
Step 2:	.05 times 1/365	Result:	.000136986
Step 3:	.000136986 times 30	Result:	.004109589
Step 4:	.004109589 times \$1,004.24658	Result:	\$4.127040740
Step 5:	Round \$4.127040740	Result:	\$4.12704
Step 6:	\$4.12704 plus \$1,004.24658	Result:	\$1,008.37362

Month of May, 20X5

Step 1:	5.00 divided by 100	Result:	.05
Step 2:	.05 times 1/365	Result:	.000136986
Step 3:	.000136986 times 31	Result:	.004246575
Step 4:	.004246575 times \$1,008.37362	Result:	\$4.282134551
Step 5:	Round \$4.282134551	Result:	\$4.28213
Step 6:	\$4.28213 plus \$1,008.37362	Result:	\$1,012.65575

Month of June, 20X5

Step 1:	5.00 divided by 100	Result:	.05
Step 2:	.05 times 1/365	Result:	.000136986
Step 3:	.000136986 times 30	Result:	.004109589
Step 4:	.004109589 times \$1,012.65575	Result:	\$4.161598973
Step 5:	Round \$4.161598973	Result:	\$4.16160
Step 6:	\$4.16160 plus \$1,012.65575	Result:	\$1,016.81735

Month of July, 20X5

Step 1:	5.00 divided by 100	Result:	.05
Step 2:	.05 times 1/365	Result:	.000136986
Step 3:	.000136986 times 31	Result:	.004246575
Step 4:	.004246575 times \$1,016.81735	Result:	\$4.317991486
Step 5:	Round \$4.317991486	Result:	\$4.31799
Step 6:	\$4.31799 plus \$1,016.81735	Result:	\$1,021.13534

Month of August, 20X5

Step 1:	5.00 divided by 100	Result:	.05
Step 2:	.05 times 1/365	Result:	.000136986
Step 3:	.000136986 times 31	Result:	.004246575
Step 4:	.004246575 times \$1,021.13534	Result:	\$4.336328156
Step 5:	Round \$4.336328156	Result:	\$4.33633
Step 6:	\$4.33633 plus \$1,021.13534	Result:	\$1,025.47167

(See "Rounding Rules for Dividends Used in the APY Calculation: for rounding rules for the dividend amounts).

Another way of calculating dividends on this 6-month share certificate is by assuming each compounding period has an equal number of days, except the last period which has enough days to account for the remaining term of the share certificate. As an example, assume month 1 through month 5 has 30 days (for a total of 150 days) and month 6 has 34 days (the actual number of days of 184 minus 150). If two conditions are met, the APY calculation based on a single compounding period could be used. (See "*Short-Cuts to the APY Calculation*", Short-Cut Illustration 2).

Formula 1 of the dividend calculation method could not be used for this example. Using Formula 1 of the dividend calculation method would result in an erroneous APY since the compounding period for this example is monthly and the term is less than a year. *Formula 1 of the dividend calculation*

method for term share accounts less than a year can only be used when the compounding period is daily.

EXAMPLE 3 - Using Dividend Calculation Formula 2:

Assume the same facts in Example 1 of this section: the account is a regular share account with no stated maturity. Principal is \$1,000. The credit union compounds monthly. The dividend rate is 5.00%. The daily rate is 1/365. The days in the month are 31 days. Placing the numbers in Formula 2 of the dividend calculation, the dividend amount for a single month in the year is \$4.24658. (See "*Short-Cuts to the APY Calculation*", Short-Cut Illustration 2, Example 1 for the APY calculation).

Dividends = Principal * Daily Dividend Rate * Days in Term

Month with 31 days

Step 1:	5.00 divided by 100	Result:	.05
Step 2:	.05 times 1/365	Result:	.000136986
Step 3:	.000136986 times 31	Result:	.004246575
Step 4:	.004246575 times \$1,000	Result:	\$4.246575342
Step 5:	Round \$4.246575342	Result:	\$4.24658

EXAMPLE 4 - Using Dividend Calculation Formula 2:

Assume the same facts in Example 2 of this section: a 6 month share certificate for \$1,000. The credit union compounds monthly. The dividend rate is 5.00%. The days in the month are 31 days. Placing the numbers in Formula 2 of the dividend calculation, the dividend amount for a single month in the 6-month term share certificate is \$4.24658 (as in Example 3 of this section). (See “*Short-Cuts to the APY Calculation*”, Short-Cut Illustration 2, Example 1 for the APY calculation).

Rounding Rules for Dividends Used in the APY Calculation

A credit union should round dividends to five or more decimals. As an example, yearly dividends earned of \$51.161897920 (5.00% for a 1/365 daily rate on \$1,000, compounded monthly) would be rounded to no less than \$51.16190 in determining the APY calculation. The fifth decimal place should be rounded up if the sixth decimal place is five or more. To illustrate, the sixth decimal place of \$51.161897920 is a “7”, thereby the fourth and fifth decimal place were rounded up from “89” to “90”.

The dividend amount of \$51.16190 would be used in calculating the APY. (See “Examples of Dividend Calculations in Determining Dividends Used in the APY Calculation”, Example 1, and the example in “APY Calculation for a Non-Term Share Account” for the use of this dividend amount).

APY Formula

Section 707.2(c), *Definitions*, defines the APY as a percentage rate that reflects the total amount of dividends paid on an account, based on the dividend rate and frequency of compounding for a 365-day period and calculated according to the rules in Appendix A, Part I of Part 707, *Truth In Savings*. The APY formula is as follows:

$$APY = 100[(1 + \text{Dividends/Principal})^{(365/\text{Days in Term})} - 1]$$

- *Dividends* are the total dollar amount of dividends earned on the Principal for the term of the account.
- *Principal* is the amount of funds assumed to have been deposited at the beginning of the account.
- *Days in Term* are the actual number of days in the term of the account.

APY Calculation

The dividend amounts from the examples provided in “*Examples of Dividend Calculations in Determining Dividends Used in the APY Calculation*” have been used in the APY examples provided in this section. APY examples have been provided for a non-term share account, a term share account, a stepped-rate account, a tiered-rate account, and a non-compounding multi-year term share account.

Also provided are illustrations and examples of APY short-cuts.

APY Calculation for a Non-Term Share Account

EXAMPLE:

Assume the same facts of Example 1, i.e., the account is a regular share account with no stated maturity. Principal is \$1,000. The credit union compounds monthly. The dividend rate is 5.00%. Dividend amount for the year is \$51.16190. (See “*Examples of Dividend Calculations in Determining Dividends Used in the APY Calculation*”, Example 1 for the dividend calculation.) Placing the numbers in the APY formula, the APY is 5.12%.

$$\text{APY} = 100[(1 + \text{Dividends/Principal})^{(365/\text{Days in Term})} - 1]$$

Step 1:	\$51.16190 divided by \$1,000	Result:	.05116190
Step 2:	.05116190 plus 1	Result:	1.05116190
Step 3:	1.05116190 raised to the exponent of 365 divided by 365	Result:	1.05116190
Step 4:	1.05116190 minus 1	Result:	.05116190
Step 5:	.05116190 times 100	Result:	5.116190
Step 6:	Round 5.116190	Result:	5.12%

Step 3 may be omitted if the “Days in Term” are 365. In other words, if the term is one year or the account has not stated maturity; such as regular shares, share drafts, etc., step 3 may be omitted. If step 3 is required, the calculating equipment, i.e., calculator, must have an exponent function as illustrated below. (See Rounding and Accuracy Rules for the APY” for rounding rules for APY).

EXPONENT FUNCTION: Y^X

The APY reflects only dividends and does not include the value of any bonus and it excludes any amounts that are determined by circumstances that may or may not occur. The APY can be calculated using an anticipated (projected or prospective) dividend rate or the dividend rate at the last dividend declaration date. If an APY is based on anticipated (projected or prospective) dividends, this must be disclosed as such in the account disclosures and advertisements.

APY Calculation for a Term Share Account

The APY for term share accounts may be based on either the actual number of days during the applicable period, or the number of days that would occur for any actual sequence of that many calendar

months. However, the same number of days, “Days in Term”, used to calculate the dividend amount must also be used to calculate the APY.

EXAMPLE:

Assume the same facts of Example 2, i.e., a 6-month share certificate for \$1,000. The credit union compounds monthly. The actual number of days in the share certificate is 184 (from March 1, 20X5 to August 31, 20X5). The number of days for any actual sequence of 6 months ranges from 181 to 184. The dividend rate is 5.00%. The dividend amount for 6 months on 184 days (actual number of days) is \$25.47167. (See “*Examples of Dividend Calculations in Determining Dividends Used in the APY Calculation*”, Example 3 for the dividend calculation.) Placing the numbers in the APY formula, the APY is 5.12%.

$$APY = 100[(1 + \text{Dividends/Principal})^{(365/\text{Days in Term})} - 1]$$

Step 1:	\$25.47267 divided by \$1,000	Result:	..02547167
Step 2:	.02547167 plus 1	Result:	1.02547167
Step 3:	1.02547167 raised to the exponent of 365 divided by 184	Result:	1.051160979
Step 4:	1.051160979 minus 1	Result:	.051160979
Step 5:	.051160979 times 100	Result:	5.1160979
Step 6:	Round 5.1160979	Result:	5.12%

In step 3, 365 is divided by 184 (actual number of days) versus 181, 182, or 183 (the number of days for actual sequence of 6 months) because the dividend amount of \$25.47 is based on 184 days. If the dividend amount was based on 181 days, step 3 would be 365 divided by 181. (See "Rounding and Accuracy Rules for the APY" for rounding rules for the APY).

The illustrations above are shown per the definition of the APY; dividends are based on the term of the account. The term for the regular share account, in "APY Calculation for a Non-Term Share Account" is 365 days since non-term share accounts are assigned a "term" of 365. The term for the 6-month share certificate, in the example of this section can be 181, 182, 183, or 184 days. However, since both examples were of monthly compounding, the APY results were the same: 5.12%.

Short-Cuts to the APY Calculation

Short-Cut Illustration 1:

A short-cut for calculating the APY without first calculating the dividend amount can be used on accounts with a single dividend rate (no stepped-rate accounts or pure/split-rate tiered-rate accounts) and a 365-day term or no term, i.e., regular share accounts and share draft accounts. This short-cut formula cannot be used in a leap year.

The short-cut is Formula 1 of the dividend calculation method with one difference: "Principal" is replaced by 100 in the formula. (See "APY Formula" for Formula 1 of the dividend calculation method).

$$APY = 100 * [(1 + (\text{Comp'ding Periods} / \text{Term})^{(\text{Nominal Rate/Comp'ding Period})} - 1]$$

- *Nominal rate* is determined by dividing the dividend rate (not expressed as a percentage) by 100 or the dividend rate expressed as a decimal.
- *Comp'ding Period* stands for a compounding period. Use the following based on the compounding period: Daily - 360 or 365, Weekly - 52, Bi-Weekly - 26, Semi-Monthly - 24, Monthly - 12, Quarterly - 4, Semi-annually - 2, Annually - 1.
- *Comp'ding Periods in Term* stands for compounding periods in term. If a daily compounding period is used, i.e., 360 or 365, the term is expressed in the number of days: 365. If a compounding period other than daily is used, the term is expressed as the same number that was expressed for the compounding period: Weekly - 52, Bi-Weekly - 26, Semi-Monthly - 24, Monthly - 12, Quarterly - 4, Semi-annually - 2, Annually - 1.

Short-Cut Illustration 2:

A short-cut where the dividend amount used in the APY calculation can be based on a single compounding period within the term or year can be used if two conditions are met. The two conditions are: 1) the same dividend rate is applicable to all the periods within the year/step (for non-term share accounts and stepped-rate accounts), or within the term (for term share accounts) (no pure/split-rate tiered-rate accounts), and 2) if a term share account is greater than a year, the compounding period is other than none (no compounding or at maturity).

If different dividend rates exist within a term/step or a year, or the compounding period is none (no compounding or at maturity) for a term share account that is greater than one year the APY calculation must be based on dividends for the full term or year of the account rather than on a single compounding period within the term or year of the account.

This short-cut can be used when the dividend rate is 10.00% or less without an erroneous APY resulting. However, since the higher dividend rates may result in an erroneous APY when this short-cut is used, this short-cut should not be used when the dividend rate is greater than 10.00% (the APY calculation must be based on dividends for the full term or year of the account).

EXAMPLE 1:

Assume the same facts of Example 1, except that the dividend amount is \$4.24658 which is based on a single month in the year. The days in the month are 31 days. (See “*Examples of Dividend Calculations in Determining Dividends Used in the APY Calculation*”, Example 3 for the dividend calculation). Placing the numbers in the formula, the APY is 5.12%.

$$APY = 100[(1 + \text{Dividends/Principal})^{(365/\text{Days in Term})} - 1]$$

Step 1:	\$4.24658 divided by \$1,000	Result:	.00424658
Step 2:	.00424658 plus 1	Result:	1.00424658
Step 3:	1.00424658 raised to the exponent of 365 divided by 31	Result:	11.05119867
Step 4:	1.051159867 minus 1	Result:	.051159867
Step 5:	.051159867 times 100	Result:	5.1159867
Step 6:	Round 5.1159867	Result:	5.12%

(See “Rounding and Accuracy Rules for the APY” for rounding rules for the APY).

EXAMPLE 2:

Assume the same facts of Example 2, except that the dividend amount is \$4.24658 which is based on a single month in the 6-month share certificate. The days in the month are 31 days. Placing the numbers in the APY formula, the APY is 5.12%. The illustration of the APY calculation in Example 1 of this section is the same illustration that would be used for this example.

APY Calculation for a Stepped Rate Account

Section 707.2(w), *Definitions*, defines a stepped-rate account as an account that has two or more dividend rates that take effect in a succeeding period and are known when the account is opened. For stepped-rate accounts a single composite APY must be disclosed.

EXAMPLE:

Assume the dividend rate for the first month of a 6-month share certificate is 5.00% and the dividend rate for the remaining 5 months is 4.75%. The compounding period is monthly. The principal amount is \$1,000. Since both conditions of Short-Cut Illustration 2 of “*Short-Cuts to the APY*

Calculation” are met, the APY for the two steps can be based on a single compounding period. Placing the numbers in Formula 2 of the dividend calculation, the dividend amount for the first step’s first month of 31 days is \$4.24658 and the dividend amount for the second step’s first month of 28 days is \$3.65931.

Dividends = Principal * Daily Dividend Rate * Days in Term

Month with 31 days

Step 1:	5.00 divided by 100	Result:	.05
Step 2:	.05 times 1/365	Result:	.000136986
Step 3:	.000136986 times 31	Result:	.004246575
Step 4:	.004246575 times \$1,000	Result:	\$4.246575342
Step 5:	Round \$4.246575342	Result:	\$4.24658

Month with 28 days

Step 1:	4.75 divided by 100	Result:	.0475
Step 2:	.0475 times 1/365	Result:	.000130137
Step 3:	.000130137 times 28	Result:	.003643836
Step 4:	.003643836 times \$1,004.24658	Result:	\$3.659309456
Step 5:	Round \$3.659309456	Result:	\$3.65931

(See “Rounding Rules for Dividends Used in the APY Calculation” for rounding rules for the dividend amounts).

Placing the numbers in the APY formula, the composite APY is 4.99%.

$$APY = 100[(1 + \text{Dividends/Principal})^{(365/\text{Days in Term})} - 1]$$

Step 1:	\$4.24658 + \$3.65931	Result:	\$7.90589
Step 2:	.00790589 + 1	Result:	1.00790589
Step 3:	1.00790589 raised to the exponent of 365 divided by 59	Result:	1.04988522
Step 4:	1.04988522 minus 1	Result:	.04988522
Step 5:	.04988522 times 100	Result:	4.988522
Step 6:	Round to 2 decimal places	Result:	4.99

(See “Rounding and Accuracy Rules for the APY” for rounding rules for the APYs).

APY Calculation for Tiered Rate Account

Section 707.2(y), *Definitions*, defines a tiered-rate account as an account that has two or more dividend rates that are applicable to specific balances.

There are two types of tiered-rate accounts: pure/split-rate and the hybrid/plateau tiered-rate account. Example 1 is based on a pure/split-rate tiered-rate account where the dividend rate is paid only on the portion of the share account balance that falls within each tier. Example 2 is a hybrid/plateau tiered-rate account where a dividend rate is paid based on the entire amount in the account.

EXAMPLE 2: Pure/Split-rate Tiered-rate Account

Assume the dividend rate for amounts from \$0.1 to \$2,500 is 5.00%, for amounts from \$2,500.01 to \$10,000 is 5.25%, and for amounts from \$10,000.01 and greater is 5.50%. If a member has \$11,000 on deposit; a dividend rate of 5.00% would be applied to \$2,500, a dividend rate of 5.25% would be applied to \$1,000 (\$11,000 minus \$10,000). For pure/split-rate tiered-rate accounts, two APYs must be disclosed for each tier except for the first tier. Therefore a total of five APYs would be disclosed; one APY for the first tier (dividend rate of 5.00%), two APYs for the second tier (dividend rate of 5.25%), and two APYs for the third tier (dividend rate of 5.50%). The two APYs disclosed in the second and third tiers are based on the tier's lower limit (\$2,500.01 for the second tier and \$10,000.01 for the third tier) and the tier's higher limit (\$10,000 for the second tier and \$100,000 for the third tier). If the board of directors has not determined a maximum amount for the third tier's higher limit, it is recommended that the insured limit of \$100,000 be used.

The APY for the first tier would be based on a principal amount of \$2,500 at 5.00%. The APYs for the second and third tiers are based on two different principal amounts; a principal amount that meets the tier's lower limit and a principal amount that meets the tier's higher limit. Illustrations of the principal amounts and the dividend calculations are as follows:

Second Tier's:

- Lower Limit - Principal amount is \$2,500.01. Multiply \$2,500 by 5.00%

and multiply \$.01 by 5.25%. Add up the two dividend amounts and place it in the APY formula. The result will be the APY for the second tier's lower limit.

- Higher Limit - Principal amount is \$10,000. Multiply \$2,500 by 5.00% and multiply \$7,500 (\$10,000 minus \$2,500) by 5.25%. Add up the two dividend amounts and place it in the APY formula. The result will be the APY for the second tier's higher limit.

Third Tier's:

- Lower Limit - Principal amount is 10,000.01. Multiply \$2,500 by 5.00%, multiply \$7,500 (\$10,000 minus \$2,500) by 5.25%, and multiply \$.01 by 5.50%. Add up the three dividend amounts and place it in the APY formula. The result will be the APY for the third tier's lower limit.
- Higher Limit - Principal amount is \$100,000. Multiply \$2,500 by 5.00%, multiply \$7,500 by 5.25%, and multiply \$90,000 by 5.50%. Add up the three dividend amounts and place it in the APY formula. The result will be the APY for the third tier's higher limit.

EXAMPLE 1: Hybrid/Plateau Tiered-rate Account

Assume the same facts of Example 1 of this section: the dividend for amounts from \$0.1 to \$2,500 is 5.00%, for amounts from \$2,500.01 to \$10,000 is 5.25%, and for amounts from \$10,000.01 and greater is 5.50%. If a member has \$5,050.00 on deposit, a dividend rate of 5.25% would be applied to \$5,050.00. If a member has \$11,000 on deposit, a dividend rate of 5.50% would be applied to \$11,000.

APY Calculation for a Non-compounding Multi-Year Term Share Account

This section provides guidance on calculating the APY on term share accounts with a maturity greater than one year. Term share accounts with

a maturity greater than one year that do not compound “no compounding or at maturity” will result in an APY that seems anomalous. For term share accounts with terms less than one year, the APY formula results in a rate greater than the dividend rate, even for accounts that do not compound. That’s because the formula assumes that dividends are compounded at maturity, and the results are “annualized”. As can be illustrated, the APY for a non-compounding term share account with terms less than one year is the same APY that would result if the term was equated to a compounding period. The APY for a 3-month non-compounding share certificate at a 5% dividend rate is 5.09%. The APY for a 12-month, quarterly compounding share certificate at a 5% dividend rate is 5.09%. Equating the 3-month

term to quarterly compounding, the APY result is the same.

For term share accounts with maturities longer than one year that do not compound at least annually, the APY is less than the dividend rate. That’s because these accounts are also annualized.

EXAMPLE 1:

Assume a two-year (730-day) non-compounding share certificate for \$1,000. The dividend rate is 5.00%. The daily rate is $1/365$. The dividend amount over the two year term is \$100 ($.05 \times (1/365) \times \$1,000$). Placing the numbers in the APY formula, the APY is 4.88%.

$$\text{APY} = 100[(1 + \text{Dividends/Principal})^{(365/\text{Days in Term})} - 1]$$

Step 1:	\$100 divided by \$1,000	Result:	.1
Step 2:	.1 plus 1	Result:	1.1
Step 3:	1.1 raised to the exponent of 365 divided by 730	Result:	1.048808848
Step 4:	1.04880884 minus 1	Result:	.048808848
Step 5:	.048808848 times 100	Result:	4.8808848
Step 6:	Round 4.8808848	Result:	4.88%

(See “Rounding and Accuracy Rules for the APY” for rounding rules for the APY).

EXAMPLE 2:

To understand how the APY on a two-year (730-day) non-compounding share certificate is less than the dividend rate of 5.00%, assume the following: a member opened a one-year annual compounding share certificate with a dividend

rate of 4.88088% (should be expressed to five decimal places) and then rolled the principal and dividends into another identical one-year annual compounding share certificate with a dividend rate of 4.88088% (When expressed to five decimal places). The dividend amount for the two years is the same: \$100.00

Year One

Step 1:	4.88088 divided by 100	Result:	.0488088
Step 2:	\$1,000 times .0488088	Result:	\$48.8088
Step 3:	Round \$48.8088	Result:	\$48.81

Year Two

Step 4:	\$1,000 plus \$48.81	Result:	\$1,048.81
Step 5:	\$1,048.81 times .0488088	Result:	\$51.191157528
Step 6:	\$51.191157528 plus \$1,048.81	Result:	\$1,100.0011575 3
Step 7:	\$1,100.001157543 minus \$1,000	Result:	\$100.00115753
Step 8:	Round \$100.00115753	Result:	\$100.00

Thereby, terms being equal, the dividend rate of an annual compounding term share account is equivalent to the APY of a multi-year non-compounding term share account. (See “Rounding Rules for Dividends Used in the APY Calculation” for rounding rules for the dividend amount.)

Rounding and Accuracy Rules for the APY

Section 707.3, General Disclosure Requirements, outlines the rounding and accuracy requirements for the APY.

Rounding rules require APYs to be rounded to the nearest 1/100 of 1% (.01% or .0001) and expressed to two decimal places. As an example, an APY of 5.116% would be rounded to 5.12%. The second decimal place should be rounded up if the third decimal place is five or more. To illustrate, the third decimal place of 5.116 is “6”, thereby the second decimal place would be rounded up from a “1” to a “2”.

The tolerance rate for APY accuracy is not more than 1/20 of 1% (.05% or .0005) above or below the APY as determined in Appendix A, Part I of Part 707, *Truth In Savings*.

Annual Percentage Yield Earned (APYE)

Appendix A, Part II of Part 707, *Truth In Savings*, provides the APYE formula that is to be used in periodic statements. Section 707.2(t), Definitions, defines periodic statements as statements that set forth information about an account (other than a term share account or passbook account) and are provided to a member on a regular basis four or more times a year. Regulation E identifies when statements must be provided and when they need not be provided if certain conditions are met. There are no APYE disclosure requirements for passbook accounts or term share accounts. Section 707.2(s), Definitions, defines passbook accounts as accounts in which the member retains a book or other document in which the credit union records transactions on the account. Section 707.2, Definitions, defines term share accounts as being any share certificate, certificate of deposit, or other account with a maturity of at least seven days in which the member generally does not have the right to make withdrawals for six days after the account is opened, or the account is subject to an early withdrawal penalty of at least

seven days dividends on amounts withdrawn. A term share account could also include a club account, i.e., Christmas Club Account, Vacation Club Account, Youth Club Account, etc., if the terms of the club account meet the definition of a term share account.

The APYE is member specific and thereby takes into account an account's fluctuations during the period, such as deposits and withdrawals. The APYE is similar to the APY in that both calculations show the relationship of dividends to a balance, for purposes of comparing an account's yield. However, the two calculations are different; among the differences are:

- The APYE looks backward instead of forward. The APYE formula uses dividends actually earned, not dividends projected to be earned.
- The APYE uses the average daily balance of an account during the period, instead of an initial principal amount, i.e., \$1,000.

Because of these differences, an APYE disclosed on a member's periodic statement will not necessarily equal the APY that was disclosed to the member when the account was opened, even if the dividend rate remains the same over that period.

Rounding Rules for Dividends Used in the APYE Calculation

Dividends should be rounded to two decimals for calculating the APYE. For boards of directors that elect to disclose an anticipated (projected or prospective) dividend amount and APYE on statements sent more frequently than the crediting period, the credit union does not have to round accrued anticipated (projected or prospective) dividends to two decimals for calculating the anticipated (projected or prospective) APYE on the statements that are sent more frequently than the crediting period. However, for the statement that

is sent at the end of the crediting period, the dividend earned figure must reflect the amount actually paid. As an example, if dividends earned for the statement, that is sent at the end of the crediting period, is \$15.08717 and the credit union pays the member \$15.09, the credit union must use \$15.09 (not \$15.08717) to calculate the APYE.

APYE Formula

The APYE formula is in Appendix A, Part II of Part 707, Truth In Savings. The APYE formula is as follows:

$$\text{APY} = \frac{100[(1 + \frac{\text{Dividends earned}}{\text{Balance}})^{(365/\text{Days in Term})} - 1]}{\text{Days in Term}}$$

- *Dividends earned* is the actual amount of dividends accrued or paid and credited to the account for the period.
- *Balance* is the average daily balance in the account for the period.
- *Days in Period* is the actual number of days over which the dividends disclosed on the statement were earned.

Fees, bonuses, interest refunds, and extraordinary dividends are not included in the dividend figure for the APYE calculation. If an extraordinary dividend is declared, a separate dividend amount must be calculated and disclosed. An APYE based on the extraordinary dividends may be calculated and disclosed.

Average Daily Balance Calculation

The "balance" in the APYE calculation is defined as the average daily balance in the account for the period. The following illustration of a member's account activity for a month is from "Dividend Calculation Methods":

		BALANCE
Balance: December 31, 20X4		\$1,000
Deposit: January 1, 20X5	200	1,200
Withdrawal: January 2, 20X5	100	1,100
Withdrawal: January 10, 20X5	400	700
Deposit: January 15, 20X5	200	900
Withdrawal: January 16, 20X5	1,000	-100
Deposit: January 18, 20X5	300	200
Deposit: January 21, 20X5	700	900
Withdrawal: January 31, 20X5	100	800

EXAMPLE 1:

The following illustrates how the average daily balance is determined based on the member's account activity:

	BALANCE x NUMBER OF DAYS	ACCUMULATED BALANCE
1/1/X5	\$1,200 x 1	\$1,200
1/2/X to 1/9/X5	1,100 x 8	8,800
1/10/X5 to 1/14/X5	700 x 5	3,500
1/15/X5	900 x 1	900
1/16/X5 to 1/17/X5	0 x 2	0
1/18/X5 to 1/20/X5	200 x 3	600
1/21/X5 to 1/30/X5	900 x 10	9,000
1/31/X5	800 x 1	800
TOTAL	31	24,800

Dividing the accumulated "end of day" balances of \$24,800 by 31 (the total number of days in the dividend period), the average daily balance is \$800.00000. For overdrawn accounts, use zero as the balance. Negative balances cannot be used in determining the average daily balance.

A credit union should round the average daily balance to five or more decimals. An average daily balance of \$800.12345678 would be rounded to no less than \$800.12346. The fifth decimal place should be rounded up if the sixth decimal place is five or more. The sixth decimal place of

\$800.12345678 is a "6", thereby the fifth decimal place would be rounded up from "5" to "6".

APYE Calculations**EXAMPLE 1:**

Assume that \$3.40 of dividends is earned during the period using the daily balance method. The dividend rate is 5.00% using a daily rate of 1/365. The compounding period is monthly. The crediting period is monthly. The statement period is monthly. The account activity is from "Average Daily Balance Calculation".

BALANCE x RATE x NUMBER	DIVIDEND
-------------------------	----------

	OF DAYS	AMOUNT
1/1/X5	\$1,200 x .00013698630 x 1	\$0.164383562
1/2/X to 1/9/X5	1,100 x .00013698630 x 8	.205479452
1/10/X5 to 1/14/X5	700 x .00013698630 x 5	.479452055
1/15/X5	900 x .00013698630 x 1	.123287671
1/16/X5 to 1/17/X5	0 x .00013698630 x 2	0.000000000
1/18/X5 to 1/20/X5	200 x .00013698630 x 3	0.082191781
1/21/X5 to 1/30/X5	900 x .00013698630 x 10	1.232876712
1/31/X5	800 x .00013698630 x 1	0.109589041
TOTAL	31	3.397260274

Placing the numbers in the APYE formula, the APYE is 5.12%. The “balance” (average daily balance) of \$800.00 is based on Example 1 of “Average Daily Balance Calculation”.

$$APY = 100[(1 + \text{Dividends earned}/\text{Balance})^{(365/\text{Days in Term})} - 1]$$

Step 1:	Round \$3.397260274	Result:	\$3.40
Step 2:	\$3.40 divided by \$800.00000	Result:	.004250000
Step 3:	.004250000 plus 1	Result:	1.004250000
Step 4:	1.004250000 raised to the exponent of 365 divided by 31	Result:	1.051202017
Step 5:	1.051202017 minus 1	Result:	.051202017
Step 6:	.051202017 times 100	Result:	5.120201670
Step 7:	Round 5.120201670	Result:	5.12

In this example, since the dividend earned figure is the amount actually paid (statements are not sent more frequently than dividends are credited or compounded), the credit union must round the dividends to two decimals for calculating the APYE. (See “*Rounding Rules for Dividends Used in the APYE Calculation*” for rounding rules for the dividend amount used in the APYE formula and see “*Rounding and Accuracy Rules for the APYE*” for rounding rules for the APYE).

Special APYE Formula

The special formula is used when a credit union using the daily balance method to accrue dividends sends periodic statements more often than the period for which dividends are compounded. As an example, an account that receives quarterly statements (since the compounding period is quarterly) and is subject to Regulation E’s rule (calling for monthly statements when an electronic fund transfer has occurred). A credit union may, but need not, use this formula to calculate the APYE for the quarterly statement when no

monthly statements are issued for the quarter. However, this special APYE formula must be used to calculate an APYE that is disclosed on the monthly statements issued for the quarter. Also, if the dividend period is monthly, the dividend amount and APYE (that is based on the special APYE formula) will be “earned but uncredited”. If the dividend period is quarterly, the dividend amount and APYE (that is based on the special APYE formula) will be an anticipated (projected or prospective) dividend amount and APYE. The special APYE formula in Appendix A, Part II (B) of Part 707, *Truth In Savings* is:

$$\text{APYE} = 100 \left[\left\{ 1 + \frac{\text{Dividends earned/Balance}}{\text{Days in Period (Compounding)}} \right\}^{(365/\text{Compounding})} - 1 \right]$$

- *Dividends earned* is the actual amount of dividends accrued or paid and credited to the account for the period.
- *Balance* is the average daily balance in the account for the period.
- *Days in Period* is the actual number of days over which the dividends disclosed on the statement were earned.
- *Compounding* is the actual number of days in each compounding period.

Special APYE Calculation

Assume the same facts as in “Average Daily Balance Calculation” and in Example 1 of “APYE Calculations”, except the account compounds quarterly. Also, assume dividends are credited quarterly, this is the first month of the quarter, there are 31 days in the first month, and 91 days in the quarter. Placing the numbers in the special APYE formula, the anticipated APYE is 5.09%.

$$\text{APYE} = 100 \left[\left\{ 1 + \frac{\text{Dividends earned/Balance}}{\text{Days in Period (Compounding)}} \right\}^{(365/\text{Compounding})} - 1 \right]$$

Step 1:	Round to five, \$3.397260274	Result:	\$3.39726
Step 2:	Round to five, \$800.00000	Result:	\$800.00000
Step 3:	3.39726 divided by \$800.00000	Result:	.004246575
Step 4:	.004246575 divided by 31	Result:	.000136986
Step 5:	.000136986 times 91	Result:	.012465752
Step 6:	.012465752 plus 1	Result:	1.012465752
Step 7:	1.012465752 raised to the exponent of 365 divided by 91	Result:	1.050946264
Step 8:	1.050946264 minus 1	Result:	.050946218
Step 9:	.050946218 times 100	Result:	5.094621775
Step 10:	Round 5.094621775	Result:	5.09%

Since the compounding and crediting period is quarterly, if a monthly statement is sent, the credit union does not have to round accrued dividends to two decimals for calculating the anticipated (projected or prospective) APYE for the months that statements are sent more frequently than dividends are compounded (the first monthly statement and the second monthly statement issued during the quarter). However, on the quar-

terly statement, the dividends earned figure used in the APYE formula must reflect the amount actually paid. As an example, if dividends earned for a statement period is \$15.08717 and the credit union pays the member \$15.09, the credit union must use \$15.09 (not \$15.08717) to calculate the APYE.

Dividend Period Length Versus Statement Period Length for the APYE

A credit union can choose to disclose APYEs based on the length of the dividend period. As an example, a credit union that compounds and credits dividends monthly but issues quarterly statements can show on the quarterly statement a single APYE for the entire quarter, or three APYEs (one for each crediting period in the statement period). Generally speaking, other

things being equal, the APYE will be higher (or at least no lower) if the credit union chooses to disclose for a shorter period.

EXAMPLE 1:

The following illustrates three monthly APYEs and one quarterly APYE. The dividend calculation method is based on the average daily balance.

	January	February	March
Dividend Rate	5.00%	5.00%	5.00%
Dividends	\$4.25	\$3.85	\$4.28
Average daily balance	1,000.00	1,004.25	1,008.10
Days in Period	31	28	31
APYE	5.12%	5.11%	5.11%

If instead, the credit union based the APYE on the entire quarter, the result would be:

Dividends	\$12.38
Average daily balance	1,000.00
Days in Period	90
APYE	5.11%

EXAMPLE 2:

Assume the same facts as in Example 1 of this section, except the dividend rates are different for each month.

	January	February	March
Dividend Rate	5.00%	5.25%	5.50%
Dividends	\$4.25	\$4.04	\$4.71
Average daily balance	1,000.00	1,004.25	1,008.29
Days in Period	31	28	31
APYE	5.12%	5.37%	5.64%

If instead, the credit union based the APYE on the entire quarter, the result would be:

Dividends	\$13.00
Average daily balance	1,000.00
Days in Period	90
APYE	5.38%

APYE Requirements When the Collected Balance Method is Used to Accrue and Pay Dividends

Credit unions that accrue or pay dividends on non-cash items; such as checks, must base the balance in the APYE calculation on the same balance method used to calculate dividends. As an example, a credit union that accrues or pays dividends on non-cash items using the collected balance must use the collected balance to calculate the “average daily balance” in the APYE formula.

The choice of accruing or paying dividends on the “collected” balance versus the “ledger” balance may affect a member’s dividend amount. Other things being equal, a credit union that pays on the ledger balance will pay more in dividends than a credit union that pays on the collected balance (since the ledger balance is at least as large as the collected balance). Therefore, in order to accurately reflect the APYE and provide useful information to the member, the “balance” (average daily balance) used to calculate the APYE must be the same balance method that was used to calculate dividends.

APYE on Closed Accounts

When members close their accounts during a dividend period and contractually forfeit their accrued dividends, those forfeited dividends should not be included in the APYE calculation for the period nor in the anticipated (projected or prospective) APYE calculation for the period (where statements are sent more frequent than dividends are credited). When members close their accounts during the dividend period and do not forfeit their accrued dividends, and when members open an account during the dividend period, the “balance” (average daily balance) used in the APYE calculation should only reflect the number of days the account was open versus the number of days in the period.

Rounding and Accuracy Rules for the APYE

Section 707.3, *General Disclosure Requirements*, outline the rounding and accuracy requirements for APYE.

Rounding rules require the APYE to be rounded to the nearest 1/100 of 1% (.01%) and expressed to two decimal places. As an example, an APYE of 5.116% would be rounded to 5.12%. The second decimal should be rounded up if the third

decimal is five or more. To illustrate, the third decimal of 5.116 is a "6", thereby the second decimal would be rounded up from a "1" to a "2".

The tolerance range for APYE accuracy is no more than 1/20 of 1% (.05%) above or below the APYE as determined in *Truth In Savings*, Appendix A, Part II of Part 707.

Interest Refunds Payable

Section 701.24 of the NCUA's Rules and Regulations for federal credit unions sets forth the authority for federal credit unions to refund interest to members. Under the requirements of 701.24(g), interest refunds should be shown as a reduction of interest income on the credit union's books. Also, on the credit union's Statement of Income, interest refunds should be recorded as current changes in the fiscal period to which they apply. Thus, when interest refunds are declared by the board during the first month following the close of the dividend period, they should be recorded as of the close of the dividend period by a debit to "Interests Refunds" and credit to "Interest Refunds Payable".

Interest refunds declared in the last month of the dividend period should be recorded in the same manner. The interest refunds thus will be shown on the Statement of Income prepared at the close of the period to which they apply. When the interest refunds liability credited to this account is liquidated, this account should be debited and the offsetting credit should be to "Shares" or "Cash".

Computation and Distribution of Interest Refunds

The following is a summary of the major factors involved when an interest refund is considered or authorized by the officials:

a) An interest refund can be made at the end of a dividend period only if dividends are declared and paid for that period. Only members of record at the close of business on the last day of the dividend period will be eligible for a refund of interest.

b) The interest refund shall be determined as a percentage of the total interest paid by the member. The board of directors may determine that certain loan categories, which have not made significant contributions to interest income, may be excluded from the refund. An exclusion of the refund on loans that are delinquent 2 or more months is also permitted.

The board will need to determine the rate of the refund. This should depend on the amount of funds available as well as the reserve position of the credit union. The interest refund percentage can be determined by dividing the amount available for refund by the total interest paid by eligible borrowers. For example, if \$100,000 in interest income has been collected, and \$10,000 is available for the refund (after consideration of dividends, other operating and non-operating expenses, required reserve transfers, and any other additions to reserves), the interest refund rate is 10 percent (\$10,000 divided by \$100,000 = .10 or 10 percent).

When the board determines that certain loan classifications are not considered eligible for receiving a refund, the interest refund is calculated by subtracting income earned by those loans from total income earned. The same would apply when the board of directors has determined that various loan categories will receive interest refunds at different rates. The interest income must be broken down into categories based on the different loan categories in order to determine the total interest refund.

In any case, interest income should be adjusted to delete income from borrowers who cease to be members before the close of business on the last day of the dividend period when the refund is declared. However, borrowers who have paid off their loans, but are still members, must be considered in the determination of an interest refund.

c) The refund of interest cannot be made unless it is authorized at the end of the period where a dividend on shares has also been declared and paid. But at that time, the refund can be authorized for prior periods where dividends were declared and paid but interest refunds were not

declared. This prior period authorization may only be within the calendar year.

d) After the procedures for refunding interest have been established (a. - c. above), record the total amounts of loan interest paid as determined from the members' individual share and loan ledgers. This should include interest paid by current members who paid off a loan in the period included in the interest refund authorization.

e) The amount of interest recorded is multiplied by the applicable interest refund rate, as approved by the board. The amount should either be credited to the members' savings accounts, paid by check, or a combination of both. It is suggested that the interest refund calculation worksheet be filed with the dividend record.

Entries in the Journal and Cash Record

All entries affecting this account should be recorded as "Miscellaneous" in the Journal and Cash Record.

Illustrative Entries

- a) To record interest refunds declared:

Dr.-Interest Refunds	\$750	
Cr.-Interest Refunds Payable		\$750

- b) To record the liquidation of the interest refunds liability by credits to shares and by cash payments:

Dr.-Interest Refunds Payable	\$750	
Cr.-Shares		\$625
Cr.-Cash		125

Note: When the amount recorded as an interest refund liability was based on an estimate, the difference between the total actual amount and the estimate originally recorded will require an adjusting entry. If the total actual distribution exceeded the estimate, the difference should be charged as of the liquidation date to "Interest Refunds" and credited to "Interest Refunds Pay-

able". If the estimate exceeded the total actual amount distributed, the reverse entry should be made as of the liquidation date, debiting the difference to "Interest Refunds Payable" and crediting "Interest Refunds".

Detailed Transactions

Credit:

- a) To record the amount of interest refunds declared.
- b) For the excess, if any, of actual interest refunds distributed at the authorized rate over the amount recorded in the credit entry above.

Debit:

- a) To record the amount of interest refunds distributed to members.
- b) For the excess, if any, of interest refunds recorded in the entry above, over the actual interest refunds distributed to members based on the authorized rate.

Alternative Interest Refund Procedures

Federal credit unions that pay dividends more frequently than annually may wish to employ one of the following alternatives in recording and paying interest refunds. Interest refunds may be authorized for a specific regular share account dividend period, but the payment of the interest refunds may be deferred and paid in conjunction with the closing of a regular share account dividend period later in the year. It is at that time that the board of directors decides whether the anticipated interest refunds are to be authorized and paid based upon available earnings. If so, the amount in interest refunds payable should be cleared at this time.

A credit union paying dividends quarterly or semiannually, but wishing to pay interest refunds only one time a year for all regular share account dividend periods during the year, may do so by following one of the following alternatives.

First Alternative

At the end of each regular share account dividend period during the year, the board of directors may authorize a refund of interest for that dividend period to be paid later in the year. The interest refund should be set up in the liability account, "Interest Refunds Payable". The corresponding debit should be to "Interest Refunds" for the entire amount of interest to be refunded. If the exact amount of interest to be refunded is not known, an estimate can be determined by multiplying the total interest received during the accounting period by the percentage figure selected by the board of directors to be refunded. The result obtained from this calculation will be the maximum amount of interest that can be refunded and this amount should be set up in the account, "Interest Refunds Payable". By authorizing the interest refund, the board of directors has gone on record that an interest refund for that dividend period will be paid. In its resolution, the board should also designate the date upon which the interest refund is to be paid to the members or credited to their accounts.

Second Alternative

The second alternative involves the anticipation of the payment of an interest refund. For example, the board of directors may set aside earnings at the end of a regular share account dividend period which would be earmarked for the possible payment of interest refunds at a later date in the year. In this case, the amount of the anticipated interest refund would be recorded as a debit to "Interest Refunds" and a credit to "Interest Refunds Payable".

Accrued Interest Payable (On Borrowed Funds)

For credit unions following the accrual basis of accounting, this account reflects the accrued unpaid liability of the credit union for interest on borrowed funds. The account is not required for credit unions following the modified cash basis of accounting.

Accruals should be recorded at the close of each accrual period to reflect the interest cost for the period on borrowed funds. When interest payments are made, the amounts paid should be debited to this account and credited to "Cash". Interest should be computed on borrowed funds based on the loan interest rate applied to the unpaid principal amounts of the loan liability outstanding during the accrual period. This accrual may be accomplished by applying an appropriate interest factor to the aggregate daily balances of principal outstanding at each effective interest rate.

Entries in the Journal and Cash Record

All entries affecting this account should be entered in the "Miscellaneous" columns of the Journal and Cash Record.

Illustrative Entries

- a) To accrue interest liability at the close of each accrual period:

Dr.-Interest on Borrowed		
Money	\$100	
Cr.-Accrued Interest Payable		\$100

- b) When interest is paid:

Dr.-Accrued Interest Payable	\$300	
Cr.-Cash		\$300

Detailed Transactions

Credit:

- a) With interest accrued during the accrual period.

Debit:

- a) With interest payments made.

ACCRUED EXPENSES AND OTHER LIABILITIES

ACCOUNTS PAYABLE

Accounts payable in the financial statements of a credit union typically relate to routine operating expenses. Accounts payable may also include liabilities for unclaimed or dormant share accounts and unrepresented checks. State escheat laws sometimes require that these amounts be remitted to the state after a specified period of time.

Accounts Payable

This account reflects the open account liabilities of the credit union. Examples of such items are shown below. Separate accounts should be established if there is a large number of activity relating to any one item or if outstanding balances are material relating to any one item. The separate accounts would be numbered so they could be individually identified.

Invoices For Which Prompt Payment Will not be Made

An expense item for which prompt payment will not be made may be credited to this account with an offsetting debit to the appropriate expense classification of accounts.

Cash Advances

When cash is advanced to the credit union for a specific purpose and such advance is expected to be repaid at some future date, the amount of this advance should be credited to this account with an offsetting debit to "Cash".

Unrepresented Checks

Checks issued by the credit union which have not been presented for payment after a reasonable period has elapsed (90 days or more) should be credited to this account with an offsetting debit to "Cash". The amount disbursed should be retained in this account until the statutory period prescribed for presentation of checks has expired in accordance with state escheat or abandoned property laws except for disbursed share withdrawals and loans. Disbursements of the latter type should be reversed, returning the amount paid to their source accounts. It may then be cleared by debiting this account and crediting "Other Miscellaneous Operating Income". In the event, however, that state abandoned property law provides for escheating outstanding checks, such items should be carried in "Accounts Payable" until the period provided by such law has expired, after which an amount equivalent to the total of such checks must be turned over to the state.

Most states have enacted an escheat or abandoned property law. Under this law, property which becomes dormant for a certain period of time must be reported and released to the state. Dormant accounts, unrepresented checks, and other abandoned items can become escheatable under a state law. State authorities may thus conduct limited inspections of the credit union's records to determine compliance with abandoned property laws. The value of this abandoned property should be carried in "Accounts Payable" until reported and released to the state.

Accounts of Deceased or Terminated Members

Amounts in share accounts of deceased or terminated members are transferred to this account. Refer to the Federal Credit Union Standard By-laws, Article III, Section 5(d), regarding the period of time during which an account for a deceased or terminated member could be kept open until transferred to this account.

Entries in the Journal and Cash Record

This account should be credited as "Miscellaneous-Credit" when a liability item is set up. It should be debited as "Miscellaneous-Debit" when the item is paid or other disposition is made.

Substantial expense items due and payable should be recorded promptly and at least at the end of a dividend period.

Posting to the General Ledger

The debit and credit items for Accounts Payable in "Miscellaneous" are posted individually to the General Ledger. "Explanatory Remarks" should show clearly the necessary details of the entries posted to this account, such as to whom the account is payable and the purpose. In the case of unrepresented checks, a notation should be made of the check number, date of the check and the payee.

Illustrative Entries

- a) When an expense is incurred for purchase of supplies and payment is not immediately made:

Dr.-Stationery and Supplies	\$50	
Cr.-Accounts Payable		\$50

- b) When payment is made of liabilities previously recorded in this account:

Dr.-Accounts Payable	\$50	
Cr.-Cash		\$50

Detailed Transactions

Credit:

- a) With open accounts and other liabilities recorded as Accounts Payable.
- b) With credit union checks issued after they have been outstanding a reasonable period (90 days or more).

Debit:

- a) With payments made of liabilities recorded in this account.
- b) With the amount of unrepresented credit union checks upon expiration of the statutory period for presentation of checks. Offsetting credit should be to "Other Miscellaneous Operating Income", or if escheat to the state as required, to "Cash".

Accounts Payable - Traveler's Checks And Money Orders Sold

This account is used when the credit union is acting as an agent for the sale of checks or money orders for another institution or organization. This account shows the liability to the particular vendor or other party for checks and money orders sold. The account must be supported by accurate subsidiary records to identify the specific items sold. Separate accounts payable may be established for each vendor, or each item (traveler's checks or money orders).

Entries in the Journal and Cash Record

This account should be credited as "Miscellaneous-Credit" when checks or money orders are sold by the credit union for a third party (an agent). The credit union is only liable for the amount due to the agent, which should include the face amount of the item sold plus fees owed to the agent. Any fees collected by the credit union as part of the transaction should be entered as "Miscellaneous Fee Income."

Illustrative Entries

- a) When a credit union sells a check acting as an agent for the vendor, and fees are collected which are due both to the vendor and the credit union:

Dr.-Cash	\$100.50
Cr.-Accounts Payable - Traveler's Checks and Money Orders –	
(For \$100 face amount of item sold, with a \$.50 fee charged, half of which is due to the vendor.)	\$100.25
Cr.-Miscellaneous Fee Income	
(The portion of the \$.50 fee collected, which is due to the credit union.	.25

b) When the funds collected from the sale of an item are remitted to the vendor, including fees due to the vendor:

Dr.-Accounts Payable - Traveler's Checks and Money Orders	\$100.25
Cr.-Cash	\$100.25

Accounts Payable-Undistributed Payments

This account is provided for use by credit unions to record payments received when a delay will occur before the amounts of the credits to the particular accounts are determined. The account is specifically established for those credit unions using the "total payment vendor" system.

When the credit union uses a computer or other mechanical equipment to compute interest on loans, this account should be credited with the amount of undistributed loan payments received. When the computer output record (generally the Transaction Register) is received showing the distribution of loan payments to principal and interest, this account should be debited with offsetting credits being made to loans and interest. This account should be used similarly when the distribution of the payments received on shares, loan principal and interest is made by the computer.

Where the credit union's record keeping is performed manually and in the event the breakdown of payments received to "Shares", "Loans", "In-

terest", etc., is not developed in time to provide the distribution to each General Ledger account affected, the total payments may be credited to this account and cleared when the distribution is determined.

Entries in the Journal and Cash Record

Entries affecting this account should be recorded as "Miscellaneous" unless, because of the volume of these entries, the credit union designates separate grouping for this purpose.

Illustrative Entries

a) When loan repayments are received:

Dr.-Cash	\$1,525.00
Cr.-Accounts Payable - Undistributed Payments	\$1,525.00

b) When transaction details have been determined:

Dr.-Accounts Payable - Undistributed Payments	\$1,525	
Cr.-Loans		\$1,215
Cr.-Interest on Loans		200
Cr.-Shares		110

Detailed Transactions

Credit:

a) With amounts of loan repayments received for which the detailed distribution to particular general ledger accounts has not been determined.

Debit:

a) With amounts of loan repayment transactions applied to the appropriate general ledger accounts affected.

Accounts Payable-Undistributed Payroll Deductions Or Allotments

This account is to be used when the credit union receives payroll deduction checks and the individual deductions have not yet been posted to member accounts.

Truth in Savings (TIS) requires undistributed payroll deductions to be considered part of a member's account balance upon which dividends will be calculated, unless a written contract exists between the member and the credit union. The contract must indicate, the credit union may hold the funds without adding it to the share account balance, and by doing so, the member may forfeit any dividends due them under TIS. If the deduction is for a loan payment, Truth in Lending (TIL) may impact the treatment of these accounts. To avoid any TIL violations, the deduction should be voluntary, and the member should have access to the funds.

Entries in the Journal and Cash Record

Entries affecting this account should be recorded as "Miscellaneous" in the Journal and Cash Record.

Illustrative Entries

- a) When collections are received representing payroll deductions or allotments:

Dr.-Cash	\$4,000
Cr.-Accounts Payable- Undistributed payroll Deductions or Allotments	\$4,000

- b) When distribution details have been determined based on computer processing:

Dr.- Accounts Payable- Undistributed payroll Deductions or Al- lotments	\$4,000	
Cr.-Loans		\$3,300
Cr.-Interest on Loans		300
Cr.-Shares		400

Detailed Transactions

Credit:

- a) With amounts of undistributed payroll deductions or allotments received which have been or will be sent to the computer for processing.

Debit:

- a) With amounts of payroll deductions or allotments processed by the computer and applied to appropriate other accounts affected.

Accounts Payable-Check Transmittal Service

This account is for use only by federal credit unions which provide check transmittal services to their members. The balance in the account should represent the total amount of undistributed members' paychecks payable by the credit union to the members' bank accounts. This account should be cleared by remittances to the members' banks on the day the funds are received by the credit union or as promptly as possible thereafter.

Entries in the Journal and Cash Record

All entries affecting this account should be recorded as "Miscellaneous" unless, because of volume, the credit union assigns a separate grouping for credits to this account.

Subsidiary Accounts Payable Record

The credit union must establish and maintain subsidiary accounts payable records for each depository bank to which amounts are owed.

Illustrative Entries

- a) A member presents his paycheck for a loan payment to the credit union with the remainder to be transmitted to his checking account:

Dr.-Cash	\$300	
Cr.-Loans		\$45
Cr.-Interest on Loans		5
Cr.-Accounts Payable- Check Transmittal Service		250

- b) A credit union sends a check to the member's bank checking account to forward the member's net paycheck:

Dr.- Accounts Payable- Check Transmittal Service	\$250	
Cr.-Cash		\$250

Detailed Transactions

Credit:

- a) With amounts due member's depository bank for portion of paychecks not applied to credit union accounts.

Debit:

- a) With amounts remitted to depository banks to clear this account.

Accounts Payable-Drafts Authorized

This account represents the liability of the credit union for drafts authorized to be drawn on it, where it has been legally determined that a real liability is created by the authorization. This account should not be used where a liability for drafts authorized does not arise prior to the actual acceptance of the draft by the credit union, since the drafts ordinarily will be paid concurrently with acceptance.

When a legal liability exists upon authorization of drafts, this account should be credited when authority is issued to draw drafts on the credit union:

the offsetting debit should be to the appropriate asset account, e.g., "Loans."

Entries in the Journal and Cash Record

All entries affecting this account should be recorded as "Miscellaneous" in the Journal and Cash Record.

Detailed Transactions

Credit:

- a) With amounts of drafts authorized for which the credit union has a legal liability.

Debit:

- a) With amounts of authorized drafts previously recorded in this account when presented for payment and paid or when the authorization is canceled.

Accounts Payable--Installment Payments On U.S. Bonds

This account reflects the federal credit union's liability for installment payments received toward the purchases of U.S. Savings Bonds pending sufficient funds being available for issuance of the bonds.

Section 121 of the Federal Credit Union Act provides that federal credit unions may act as agents of the U.S. Treasury Department for the sale of U.S. Savings Bonds. Only those federal credit unions that have applied to the U.S. Treasury and have been approved as issuing and/or paying agents may engage in savings bonds transactions.

When installment payments are received on bond purchases, this account should be credited with the liability for the funds pending issuance of U.S. Savings Bonds to the purchaser. When a bond is fully paid for and is issued, the purchase cost should be cleared from this account and transferred to "Accounts Payable--U.S. Savings Bond Remittance".

Illustrative Entries

- a) When payments are received on installment purchase of U.S. Savings Bonds:

Dr.-Cash or Cash-U.S. Bond Installment Payment	\$12.50
Cr.-Accounts Payable- Installment Payments on U.S. Bonds	\$12.50

- b) When a bond is fully paid and is issued:

Dr.- Accounts Payable- In- installment Payments on U.S. Bonds	\$150.00
Cr.-Accounts Payable-U.S Savings Bond Remittances	\$150.00

- c) When an authorization is canceled and a subscriber withdraws the balance on his installment account:

Dr.- Accounts Payable- Installment Payments on U.S. Bonds	\$12.50
Cr.- Cash or Cash-U.S. Bond Installment Payment	\$12.50

- d) When remittance is made to the Federal Reserve Bank for bonds issued under the installment payment plan:

Dr.- Accounts Payable- U.S Savings Bond Remittances	\$150.00
Cr.- Cash or Cash-U.S. Bond Installment Payments	\$150.00

Detailed Transactions

Credit:

- a) With installment payments received.

Debit:

- a) With installment payments withdrawn upon cancellation of a subscription.

- b) With installment amounts used for bond issuances (transfer liability to "Accounts Payable U.S. Savings Bond Remittances").

Accounts Payable-U.S. Savings Bond Remittances

This account reflects the federal credit union's liability for U.S. Savings Bonds issued pending transmittal of the funds collected to the Federal Reserve Bank.

Section 121 of the Federal Credit Union Act provides that federal credit unions may act as agents of the U.S. Treasury Department for the sale of U.S. Savings Bonds. Only those federal credit unions that have applied to the U.S. Treasury and have been approved as issuing and/or paying agents may engage in savings bonds transactions.

This account should be credited with the cash payments received covering the issue of all U.S. Savings Bonds issued by the credit union. When sufficient funds are available for the issuance of a bond to installment purchasers, the bond issue price should be transferred to this account from "Accounts Payable-Installment Payments on U.S. Bonds". Likewise, when cash is received covering the entire purchase of a U.S. Savings Bond or note purchased by installment payments, this account should be credited with the total amount received pending transmittal of the funds to the Federal Reserve Bank. When proceeds from the sales of Savings Bonds are remitted to the Federal Reserve Bank, this account should be debited.

Illustrative Entries

- a) To record the daily total cash received from the sale of Savings Bonds:

Dr.- Cash	\$75
Cr.-Accounts Payable-U.S Savings Bond Remittances	\$75

b) To record the remittance of savings bond sales to the Federal Reserve Bank:

Dr.- Accounts Payable-		
U.S Savings Bond		
Remittances	\$75	
Cr.-Cash		\$75

Notes Payable Commitment Fees

This account should reflect commitment fees paid on term notes. The fees should be amortized based on the interest method. The periodic amortization should be recorded as interest on borrowed funds. See Assets Section 300 "Accounting Entries, Loans and the Interest Method" for a detailed discussion of the interest method.

Taxes Payable

Federal Withholding Taxes Payable State Withholding Taxes Payable City Withholding Taxes Payable

Federal credit unions that pay salaries are subject to the withholding provisions of the law relating to federal, state, and local income taxes. If salaries are paid it is essential that the proper forms be obtained from each employee and kept on file. If any taxes are required to be withheld, the instructions issued by the Internal Revenue Service or other taxing authority for reporting and remitting taxes should be carefully followed. The necessary forms and instructions should be obtained from the local Director of Internal Revenue or other taxing authority.

Many states and cities have provisions in their tax laws for the withholding of income taxes similar to the federal income tax law. In these instances, forms and instructions should be obtained from the local tax officials. Where a credit union has employees for which it withholds state or city income taxes residing in more than one state, additional accounts for State Withholding Taxes Payable should be established.

Each time salaries are paid, the amount of income tax withheld from the salary is credited to this

account in the "Miscellaneous Credit" column of the Journal and Cash Record. The account is debited in the "Miscellaneous Debit" column when the amounts withheld are remitted in accordance with instructions. If the credits to this account are numerous, it is suggested that one (or more) of the blank columns of the Journal and Cash Record or the continuation sheet be used to accumulate these entries. If this is done the column(s) should be headed "Federal Withholding Taxes Payable-Cr-" (if state or city taxes are involved the column(s) should be appropriately labeled).

Employees Withholding Exemption Certificate (Form W-4)

At the time the treasurer is appointed or an employee is hired, an Employee Withholding Exemption Certificate (Form W-4) should be obtained. Blank copies of Form W-4 may be secured from the local Director of Internal Revenue. This certificate, which should be signed by the employee involved, should indicate the exemptions he is claiming. The deductions made from his salary will be governed by his exemptions. Employees Withholding Exemption Certificates (Form W-4) for each employee should be retained in the files of the credit union. The appropriate Withholding Exemption Certificate should be obtained when state or city income taxes are withheld.

Posting to the General Ledger

The items entered as "Miscellaneous" are posted individually to the General Ledger. In the event one (or more) of the blank Journal and Cash Record columns is used, the total of this column(s) is posted as a credit to the General Ledger at the end of the month.

Illustrative Entries

a) When salaries are paid and social security and federal income taxes are withheld:

Dr.-Salaries	\$100.00	
Cr.-Cash		\$86.37
Cr.-Federal Withholding Taxes Payable		10.00

Cr.-Social Security Taxes Payable	3.63
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b) When federal taxes withheld are remitted in accordance with instructions of the Internal Revenue Service, together with employer's social security tax:

Dr.-Federal Withholding Taxes Payable	\$30.00	
Dr.-Social Security Taxes Payable	21.78	
Cr.-Cash		\$51.78

Detailed Transactions

Credit:

a) With amount of income taxes withheld.

Debit:

a) With amount of income taxes remitted to the federal, state or city tax authorities, as applicable for each account.

Social Security Taxes Payable

Federal credit unions are required to withhold social security taxes on certain salaries paid. Information as to the specific requirements and procedures, including the rates currently in effect, can be obtained from the nearest field office of the Social Security Administration or the local Director of Internal Revenue.

Deductions, according to the current rate, should be made from salaries and should be accumulated in "Social Security Taxes Payable". Remittances of these deductions, together with the proper amount to cover the employer's (credit union's) tax, should be made in accordance with the instructions. Both the employees' deductions and the credit union's tax liability should be set up in the Social Security Taxes Payable each time salaries are paid. The credit union should apply to the local Director of Internal Revenue for an employer's identification number on Form SS-4. Forms on which to make this application as well

as report forms and instructions regarding their use will be supplied by the local Director upon request. The credit union must have a record of the Social Security account numbers of its employees. Any employee who does not have a number should obtain one by applying for the social security number on Form SS-4 at the nearest Social Security Field Office.

A suggested form of individual payroll ledger sheet is illustrated above. This form will help maintain control over both the employee's and employer's social security taxes, as well as deductions or withholdings made from the employee's salary for federal income tax, savings bonds, credit union, etc.

Entries in the Journal and Cash Record

When salaries are paid, the amount of social security tax required is withheld from the salary due each qualifying employee and credited to this account as a "Miscellaneous-Credit" in the Journal and Cash Record. At the same time, the employer's (credit union's) social security tax on such salaries is charged to "Social Security Taxes (Employer's Share)" and credited to this account as a "Miscellaneous Credit". When the remittance is made, this account is debited as a "Miscellaneous-Debit".

If the credits to this account are numerous, you may wish to identify the entries as "Social Security Taxes Payable-Cr."

Posting to the General Ledger

The items entered as "Miscellaneous" are posted individually to the General Ledger.

Illustrative Entries

a) When salaries are paid and social security and income taxes are withheld for later remittance to the Director of Internal Revenue:

Dr.-Salaries	\$100.00	
Cr.-Cash		\$86.37
Cr.-Federal Withholding Taxes		

Payable	10.00
Cr.-Social Security Taxes Payable	3.63

b) When salaries are paid, liability for the credit union's portion of social security tax is recorded:

Dr.-Social Security Taxes (Employer's Share)	\$3.63
Cr.- Social Security Taxes Payable	\$3.63

c) When taxes withheld from salaries are remitted to the Director of Internal Revenue together with employer's social security tax:

Dr.-Federal Withholding Taxes Payable	\$30.00
Dr.-Social Security Taxes Payable	21.78
Cr.-Cash	\$51.78

Note: When income tax withholdings affect state or city income taxes all entries should be recorded similar to the credits and debits to account, "Social Security Taxes Payable", as shown in the first and third entries above, except that the appropriate account should be credited or debited.

Detailed Transactions

Credit:

- a) With amounts of social security taxes withheld from employees' salaries.
- b) With the credit union's share of social security taxes charged to expense "Social Security Taxes (Employer's Share)", (Account No. 222).

Debit:

- a) With amount of social security taxes paid (Employees' and Employer's Shares).

Federal Unemployment Compensation Tax Payable and State Unemployment Compensation Tax Payable

These two accounts reflect the amounts of the credit union's unpaid liabilities for federal and state unemployment compensation taxes payable.

The Federal Unemployment Tax Act imposes a tax on employers who employ one or more persons in covered employment based on a certain number of weeks during the current or preceding calendar year, or who paid wages of at least a certain dollar amount during a calendar quarter in the current or preceding calendar year. Refer to FUTA for current requirements.

Unemployment compensation insurance coverage is applicable to practically all federal credit unions. Amounts paid for Unemployment Compensation Insurance are expenses to the credit union and are recorded when the liabilities are incurred.

In most states, the full tax is paid by the employer (credit union), however, in a few states the employees also contribute by a deduction from the wages. In these cases, the accounting treatment for Unemployment Compensation Insurance will be similar to that for social security taxes payable.

Report forms and instructions should be obtained from the State Employment Security Agency (State Tax) and Internal Revenue Service (Federal Tax).

Entries in the Journal and Cash Record

Expenses for Unemployment Compensation Insurance may be recorded when paid. However, the expense and the liability may be recorded on a monthly basis for more accurate financial reporting. This can be done by computing the expense monthly and charging it to "Unemployment Compensation Taxes" with a corresponding credit to "Federal Unemployment Compensation Tax Payable" or "State Unemployment Compensation Tax Payable", as appropriate. The expense is computed by applying the required percentage to taxable wages during this month.

Postings to the General Ledger

The items entered as "Miscellaneous" are posted individually to the General Ledger.

Illustrative Entries

a) At the end of the month when the liability is recorded for unemployment compensation taxes:

Dr.-Unemployment	
Compensation Taxes	\$6.00
Cr.-Federal Unemployment	
Compensation Tax Payable	\$2.00
Cr.-State Unemployment	
Compensation Tax Payable	4.00

b) When taxes are remitted to State Employment Security Agency:

Dr.- State Unemployment	
Compensation Tax Pay- able	\$4.00
Cr.-Cash	\$4.00

Detailed Transactions

Credit:

a) With amount for unemployment taxes charged to "Unemployment Compensation Taxes".

Debit:

a) With remittances made to pay the total liability for unemployment taxes to the respective taxing authorities.

Other Taxes Payable

This account reflects the current liability of the credit union for miscellaneous taxes due but unpaid, including real estate taxes, personal property taxes, etc.

Entries in the Journal and Cash Record

All entries affecting this account should be recorded as "Miscellaneous" in the Journal and Cash Record.

Illustrative Entries

a) To record the liability for real estate taxes which have become due and payable:

Dr.-Real Estate Taxes	\$500	
Cr.-Other Taxes Payable		\$500

b) To record payment of taxes for which a liability has been established in this account:

Dr.- Other Taxes Payable	\$500	
Cr.-Cash		\$500

Detailed Transactions

Credit:

a) With the actual liability for miscellaneous unpaid taxes with an offsetting charge to the appropriate operating expense account.

Debit:

a) With miscellaneous taxes previously credited to this account when paid.

ACCRUED EXPENSES

Amounts recorded in these accounts are not yet due but are so recorded to allocate the expense to the period incurred. The use of the accrual basis of accounting is preferred because it matches expenses to the period incurred, rather than when paid, and income is recorded in the period earned, rather than when received. Even those credit unions using the modified cash basis of accounting should accrue for those expenses that would significantly distort the Statement of Income if they were recorded on the cash basis.

Accrued Salaries

The amount of salaries earned but not yet paid may, if material in amount, be recorded in "Accrued Salaries" with offsetting charges to the appropriate expense classifications (Salaries, Social Security Taxes, Unemployment Compensation

Taxes). This accrued liability would be applicable, for example, where salaries are paid on a bi-weekly basis and the pay period overlaps at month-end.

Accrued Employee Benefits

When expenses for employee benefits are material in amount, the cost may be accrued by periodic charges to expenses each accrual period with an offsetting credit to "Accrued Employee Benefits". An example might be the cost of employee group life insurance where payments of the expense are made at times not conforming to the accrual periods adopted by the credit union.

Accounting for Compensated Absences

A credit union, acting as an employer, should accrue the amount of its liability for employees' compensation of future absences. The accrual need not include compensated leave that would be used in the current calendar year. The accrual should be made when all of the following conditions exist:

- a) The credit union is obligated for compensation that is attributable to services that have already been provided by its employees, such as an accumulation of "annual leave";
- b) The credit union has an obligation to make payment for the accrued leave or rights to compensation, even though an employee terminates;
- c) Payment of the accrued compensation is probable; and
- d) The amount can be reasonably estimated.

Accrued Cost Of Space Occupied

When the credit union owns its building, the expense for real estate taxes may be accrued periodically by charges to "Real Estate Taxes" and credit to "Accrued Cost of Space Occupied". Other periodic costs relating to space may be significant and may justify recognition as expenses in each accrual period by periodic charges to expense and credits to "Accrued Cost of Space Occupied".

Accrued Dividends Payable

The cost of funds is a material expense for credit unions and should be accrued by periodic charges to expense each accrual period. The accrued expense for dividends should be recorded as a debit to "Dividends" and as a credit to "Accrued Dividends Payable". Dividends that have been declared and are payable should be recorded by a debit to "Accrued Dividends Payable" and a credit to "Dividends Payable". See Illustrative Entries under account "Dividends Payable".

Accrued Accounting Service Cost

This account is used to record unpaid expenses for accounting services that are provided by an outside person or firm. It should also be used to record unpaid expenses incurred in conjunction with a jointly owned accounting service center. The accrual may be necessary if the payment is not remitted to the processor until the middle of the subsequent month. It may also be used to accrue the cost of issuing members' quarterly statements so that the costs are evenly distributed during the accounting period.

The illustrative entries, entries in the Journal and Cash Record, and the detailed transactions will be similar to those for "Other Accrued Expenses", therefore, reference should be made to that account.

Other Accrued Expenses

When a credit union has other types of unpaid expenses of material amounts that should be spread over several accrual periods, they may be allocated to expense in the periods to which they apply with an offsetting credit to "Other Accrued Expense".

Entries in the Journal and Cash Record

The entries to these accounts should be made as "Miscellaneous" in the Journal and Cash Record. The offsetting charges to expenses when the accruals are established should be separately designated for operating expense debits.

Illustrative Entries

a) To establish the accrual for salaries unpaid at period end:

Dr.-Salaries	\$300.00
Dr.-Social Security Taxes (Employer's Share)	7.50
Cr.-Accrued Salaries	\$307.50

b) To charge real estate taxes to expense monthly during the year based on an annual estimated cost of \$600.00:

Dr.-Real Estate Taxes	\$50.00
Cr.-Accrued Cost of Space Occupied	\$50.00

Detailed Transactions

Credit:

a) With amounts of periodic charges to expense representing unpaid costs in order to allocate such costs over the period to which they apply.

Debit:

a) With amounts recorded in these accounts when the actual expenses are paid. Adjustments to record differences between the accrual amounts and the actual amounts should be charged or credited, as applicable, to current operating expenses.

BORROWERS' TAXES AND INSURANCE ESCROWS***Escrow Account***

This account is used if a nonmember assumes a member's real estate loan and an escrow account is required. A subsidiary ledger should be established for each nonmember for whom an escrow account is maintained. An escrow account maintained for a nonmember bears interest at a rate equal to the dividend rate paid on regular share

accounts. The interest paid on such accounts should be added to the escrow account payable at the end of each accounting period (or more often if desired) by debiting "Other Miscellaneous Operating Expenses" and crediting this account. The interest paid should be recorded on each nonmember subsidiary ledger and should be identified as interest.

The escrow account should provide for the accumulation of funds to pay for 1 year's taxes, assessments, insurance premiums, or other charges that could affect the credit union's first lien position.

At the time the account is opened, the nonmember should be asked to sign a blanket withdrawal authorization which permits the FCU to use the funds to make the required payments. The FCU should also arrange with each nonmember for whom an escrow account is maintained to promptly submit to the FCU for payment, any statements received relating to taxes, assessments, insurance premiums and other fees which are to be paid from the escrow account. Any disbursement made from an escrow account should be supported by such documents. Withdrawals of amounts in excess of the amount required to pay the fees for which the account was established are permissible at any time. Other withdrawals, except to pay the fees for which the account was established, should be prohibited.

OTHER LIABILITIES***Other Liabilities***

This account reflects miscellaneous liabilities of the credit union for which no specific general ledger account is provided.

Entries in the Journal and Cash Record

All entries affecting this account should be recorded as "Miscellaneous" in the Journal and Cash Record.

Postings to General Ledger

Postings should be made currently as transactions occur to the General Ledger Account. The nature of the liability and the identification of the person or organization to whom the liability is owed and an explanation of all liquidating entries should be written in "Explanatory Remarks" of the General Ledger account.

Liability Under Pension Cost

This account is used to record an accumulated pension liability that occurs when post service pension costs are amortized over a period that is less than the funding period. A full discussion of pension plan accounting is beyond the scope of this Manual – seek the assistance of an independent accountant who can inform you concerning accounting rules under generally accepted accounting principles.

Undisbursed Loan Proceeds

This account is used to record the proceeds of loans that have been recorded on the credit union's records, but not yet disbursed.

Subordinated CDCU Debt

This account is used to record the declining scale for its corresponding capital account "Uninsured Secondary Capital." A regulatory accounting position (RAP)** has been taken to establish these accounts and to recognize them as secondary capital. These accounts are subordinated debt and the account holder does not have voting or ownership rights. Credit unions should record the amount of secondary capital in the equity section of the balance sheet, although any secondary capital that has a remaining maturity of less than 5 years will be split into capital and liability components based on the sliding scale in the Interim Final Rule.

**-- To be consistent with generally accepted accounting principles (GAAP), the credit union's outside auditor may recognize accounts established as secondary capital as subordinated debt, and for financial statement presentation purposes, may reflect the entire balance in these accounts in the liability section of the balance sheet.

The credit union should record the secondary capital and use the new accounts as set forth in the following examples.

Illustrative Entries

EXAMPLE #1: A low-income designated credit union accepted a secondary capital account of \$100,000 with a 6-year maturity from a nonnatural person investor. The account should be recorded:

Dr.- Cash	\$100,000	
Cr.-Uninsured Secondary Capital		\$100,000

EXAMPLE #2: When the remaining maturity of the above account is between 4 and 5 years the following adjusting entry should be recorded to reflect only 80 percent of the account as secondary capital:

Dr.- Uninsured Secondary Capital	\$20,000	
Cr. - Subordinated CDCU Debt		\$20,000

In the event that a low-income credit union has depleted its reserves and undivided earnings and incurs an operating loss, the loss will be distributed pro rata among the current secondary capital account holders.

For example, a credit union has 5 secondary capital investors, each depositing \$100,000 for total secondary capital of \$500,000. The credit union incurs an operating loss of \$120,000; each account will be debited for \$24,000. The remaining balance in each account will be \$76,000, with a total remaining secondary capital of \$380,000. A credit union that has funds split between "Uninsured Secondary Capital" and "Subordinated CDCU Debt" should first absorb any pro rata loss from "Subordinated CDCU Debt", with any remaining loss carried over to "Uninsured Secondary Capital".

If a secondary capital account holder wishes to withdraw the investment at maturity, the credit union must determine losses as of the previous month end and allocate the loss, again on a pro rata basis to all account holders, prior to releasing the funds. Keep in mind that all funds will continue to be at risk to cover losses that exceed reserves and undivided earnings regardless of their capital values based on their final maturities.

The Interim Final Rule requires that the credit union adopt a written plan for use of the funds in the accounts and subsequent liquidity needs to meet repayment requirements upon maturity. The credit union should consider reasonableness and with risk assessment in mind.

The secondary capital accounts may not be established as share accounts and, therefore, will be considered a form of subordinated debt, in effect a borrowing. In most cases of borrowed funds, the stated interest rate is guaranteed contrary to dividends on share deposits for credit unions which are limited to the amount of funds available from earnings, both current and accumulated. The credit union should consider its ability to meet the interest payment obligation in light of its current and accumulated earnings. Interest payable on these accounts must be accrued at least monthly. The credit union should consider the effect on regular members' dividends when setting the interest rate or index for these accounts.

Section 107(9) of the Federal Credit Union Act limits a credit union's borrowing to 50 percent of its paid-in and unimpaired capital and surplus. The amount held in secondary capital accounts held by low-income credit unions is to be included in total borrowings for purposes of this limitation. Secondary capital accounts, plus any other borrowings by the low-income credit union will not exceed the 50 percent limit.

Part 705 of the NCUA Rules and Regulations addresses the Community Development Revolving Loan Program for Credit Unions. A credit union participating in the program may receive up to \$300,000 in the form of a loan. A matching requirement encourages credit unions to develop

a permanent source of *member shares* within one year of loan approval.

Accounts established as secondary capital by low-income designated credit unions may not be used as a source of matching funds for this program. First, secondary capital is not a *member share* and second, the regulation requires that the credit union maintain the increase in the total amount of *share deposits* for the duration of the loan from the program. The preamble to the Interim Final Rule clearly states that these accounts "may not be offered as share accounts."

The Rule states that since secondary capital accounts are not share accounts, they are not subject to Section 701.32 limitations.

DEFERRED CREDITS

These accounts are the counterparts to deferred charges, and accordingly, are used to carry forward to future accounting periods such items as income received but not yet earned and deferred gains on the disposition of assets.

Unearned Interest On Loans

This account represents the balance of discounts established as deferred income when FHA Title I Property Improvement Loans are disbursed by credit unions if the credit union elects to follow FHA policies and procedures in handling such loans. The account should not be used by credit unions electing to provide for the application of an interest rate on the unpaid balance of Title I FHA loans in the conventional credit union manner.

Federal credit unions desiring to do so may adopt the FHA "discount" or "add-on" method for Title I loans. Under this method, the entry to record disbursement of the loan would be as follows (\$1,000 disbursed on "\$5 discount per \$100", loan payable in 24 equal monthly installments):

Illustrative Entries

Dr.-Loans	\$1,101.22
Cr.-Cash	\$1,000.00
Cr.-Unearned Interest on Loans	101.22

This account should be adjusted for the following basic conditions, although other adjustments may be needed as circumstances dictate:

a) Periodic transfers, generally monthly, to "Interest on Loans" to record earned interest. Any reasonable and logical method of recording earned interest may be used provided it is based on loan payments received, as opposed to loan payments that should have been received. It would be best if the transfer was based on a computation applied to each Title I loan individually, but if a federal credit union has numerous Title I loans, the earned interest may be computed by grouping all Title I loans. In such a case the federal credit union should keep in mind that if interest refunds are to be made, the earned interest should be recorded individually for each borrower.

b) Prepayment of the loan. Federal credit unions must make a rebate to the extent of the full unearned interest.

c) Charge off of the loan. The unearned interest should be adjusted in both this account and the individual loan account. The amount that should then be charged off will be the amount remaining in the individual loan account after applying the amount of the interest collected.

Entries in the Journal and Cash Record

All entries affecting this account should be recorded as "Miscellaneous" in the Journal and Cash Record.

Illustrative Entries

a) For recording original transaction for disbursing an FHA Title I loan:

Dr.-Loans	\$1,101.22
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Cr.-Cash	\$1,000.00
Cr.-Unearned Interest on Loans	101.22

b) For transferring unearned interest to income as the interest is earned:

Dr.- Unearned Interest on Loans	\$10.00
Cr.-Interest on Loans	\$10.00

Detailed Transactions

Credit:

a) With amounts of unearned interest on FHA loans when loans are disbursed.

Debit:

a) Periodically as interest on FHA loans is earned, with amount transferred to "Interest on Loans".

b) With refunds of unearned interest in the case on loan repayments.

c) With unearned interest when a loan is charged off; transfer to "Loans" and charge off the net unpaid balance to "Allowance for Loan Losses".

Deferred Credits-Insurance Premium Rebate

This account represents the amount of dividends on life savings and borrowers' protection insurance applicable to future periods.

When credit union life savings and borrowers' protection insurance policies provide for the payment of dividends at the discretion of the insurance company based on prior years' premiums, the period that benefits is the year after the dividends are earned (i.e., the year in which the dividends are actually received). Since the entire year benefits, it is logical to reason that each of the remaining accounting periods benefit equally. Therefore, a credit union that receives an insurance dividend credit in the first part of the year

may distribute this credit evenly over the remaining periods of the year. When dividends are received by the credit union by check, the charge for the entire amount is to "Cash" or to "Other Prepaid Insurance". Expense accounts such as "Life Savings Insurance" and "Borrowers' Insurance" or "Other Miscellaneous Operating Income" should be credited, as appropriate, with only one-twelfth, one-fourth or one-half of the amount of the dividend, depending upon the frequency of accrual periods, and the remainder of the dividend should be credited to this account. During the subsequent accounting periods in the calendar year, this account should be debited and expenses or other income should be credited for the applicable proportionate parts of the deferred amount.

Entries in Journal and Cash Record

All entries affecting this account should be recorded in the "Miscellaneous" columns of the Journal and Cash Record.

Illustrative Entries

- a) When advice of dividend credit is received and the credit union decides to spread the credit by monthly entries offsetting expenses over the entire calendar year (assume the dividend is for \$600, and 60 percent applies to life savings insurance and 40 percent applies to borrowers' insurance):

Dr.-Other Prepaid Insurance	\$600	
Cr.-Life Savings Insurance		\$30
Cr.-Borrowers' Insurance		20
Cr.-Deferred Credits-Insurance		
Premium Rebates		550

- b) Each month, to record the write-off of deferred insurance dividends as offsets to expenses during the year:

Dr.- Deferred Credits-		
Insurance Premium Rebates	\$50	
Cr.-Life Savings Insurance		\$30
Cr.-Borrowers' Insurance		20

Detailed Transactions

Credit:

- a) With the portion of dividend credits received which are to be prorated as offsetting credits to operating expenses for the remainder of the calendar year.

Debit:

- a) With periodic entries (monthly, quarterly or semiannually) to prorate the deferred credit over the calendar year.

Unamortized Discount On Sale Of Assets

This account is used when a sale of assets occurs and the purchaser offers a note as partial payment. When this account is used, the note will generally have an interest rate that is lower than the current rate of interest that would be charged to the purchaser if he or she borrowed the funds elsewhere. The Effective Interest Rate Method (simple interest applied to the unpaid balance) is thus used to discount the interest rate on the note to the current market interest rate for the transaction.

This process is used to determine the amount of recognized gain that can be realized during the current accounting period. The unrecognized gain (Unamortized Discount) is credited to this account and is amortized as income over the note's maturity.

Illustrative Entries

On January 1, 20X0, HEM FCU sells a computer to RAM FCU which originally cost \$600,000. It has total depreciation of \$300,000. RAM FCU gave HEM FCU a non-interest bearing note of \$400,000 in payment. The note was payable 3 years later. Assume that current interest rate for the first and second year would be as illustrated below:

January 1, 20X0.

Dr.-Notes and Contracts Receivable	\$400,000	of Assets	17,532
Dr.- Allowance for Depreciation of Furniture and Equipment	300,000	Cr.-Unamortized Discount on Sale of Assets	82,468
Cr.-Furniture and Equipment	\$600,000		
Cr.-Gain (Loss) on Disposition			

Computation of Gain or Loss on Disposition

Step #1 Note	x	Present value factor for 8% for 3 periods	=	Discount Present Value
\$400,000	x	.79383		\$317,532
Step #2 Note	-	Discount Present Value	=	Unamortized Discount
\$400,000	-	\$317,532		\$82,468

Step #3: Compute resulting Gain or Loss $\$400,000 - (\$600,000 - \$300,000) - \$82,468 = \$17,532$

*Computation and Recording of Interest Income
December 31, 20x0:*

Step #1:

Discounted PV x Current Interest Rate = Interest Income.

$$\$317,532 \times 8\% = \$25,402.56$$

Step #2 Entry:

Dr.- Unamortized Discount on Sale of Assets	25,402.56
Cr.-Other Non-Operating Income	25,402.56

December 31, 20X1:

Step #1: Discounted Present Value of Note, 12/31/x0, + Discount Amortization, 12/31/x0, x Current Interest Rate at Time of Sale = Interest Income

$$\$317,532 + \$25,402.56 = \$342,934.56 \times 8\% = \$27,434.76$$

Step #2: Entry:

Dr.- Unamortized Discount on Sale of Assets	27,434.76
Cr.-Other Non-Operating Income	27,434.76

Deferred Credit-Insurance Premium Stabilization Reserve

This account may be used by credit unions that are participating in risk rating plans for loan protection and life savings insurance. These insurance plans vary greatly.

Normally, when a credit union receives a premium refund, the refund represents a reduction of the premium and it should be treated as such by crediting the appropriate expense account. If the refund is for a prior period and the amount is material, then the financial statements for the prior period should be restated. On the other hand, if

the credit memo that is received by the credit union actually represents a prepayment, the "Insurance Premium Stabilization Reserve" should be debited with an offsetting credit to this account. Periodically, the deferred credit should be amortized to expense over the period benefited. Interest received, if any, on the deposit left with the insurance company should be recorded in "Other Miscellaneous Operating Income".

Entries in the Journal and Cash Record

All entries affecting this account should be recorded as "Miscellaneous" in the Journal and Cash Record.

Illustrative Entries

a) When the insurance company advises the credit union of a refund or dividend on past premiums which is to be retained and credited to the credit union's reserve account; assume the dividend is for \$600, and 60 percent applies to life savings insurance and 40 percent applies to borrowers' insurance:

Dr.-Insurance Premiums	
Stabilization Reserve	\$600
Cr.-Deferred Credits-Insurance	
Premium Stabilization Reserve	\$600

b) Each month, to record the write-off of the deferred credit as offsets to expenses:

Dr.-Deferred Credits-Insurance	
Premium Stabilization Reserve	\$50
Cr.-Life Savings Insurance	\$30
Cr.-Borrowers' Insurance	20

Detailed Transactions

Credit:

a) With refunds or dividends on past premiums when the refund or dividend is to be retained by the insurance company and credited to the credit union's reserve account.

Debit:

a) With periodic entries (monthly, quarterly or semiannually) to prorate the deferred credit over the calendar year.

Other Deferred Credits

This account represents the balance of income deferred by the credit union for which no provision is made in other accounts in this series.

Entries in the Journal and Cash Record

All entries affecting this account should be recorded as "Miscellaneous" in the Journal and Cash Record.

Detailed Transactions

Credit:

a) With amounts of miscellaneous income determined to be proper for deferred treatment.

b) With deferred income recorded in this account, when transferred to income, or when written off with the approval of the board of directors.

Deferred Credits-Net Origination Fees (Costs)-Lines Of Credit To Members

If the criteria for immateriality outlined in "Origination Fees (Costs)-Consumer Credit Transactions", are met, the fees on lines of credit should be taken directly into income and the direct costs expensed as incurred. However, if the criteria are not met, the net fees (costs) should be amortized and recognized as income using the straight-line method of amortization over the life of the credit plan. If the borrower pays all borrowings and cannot re-borrow under the contract, any unamortized net fees or costs should be recognized in income upon payment.

If the agreement provides for the option of converting a revolving line of credit to a term loan, the federal credit union should recognize the net fees or costs using the straight-line method over the combined life of the line of credit and the term loan. If the option is exercised, the net

unamortized fees (costs) are transferred to the appropriate loan contra account for net origination fees (costs). The net fees (costs) should then be treated as an adjustment of yield using the interest method. If the option is not exercised and the revolving line of credit expires and all borrowings are extinguished, the net unamortized fees (costs) should be recognized as income on the termination date.

Although there are no statutory or regulatory limitations regarding maturity, sound business practice dictates that a termination date should be built into the line of credit loan agreement. A termination date provides the lender an opportunity to reevaluate the borrower's financial position and the borrower, to reassess his or her credit needs. Termination dates establish a point at which the equity line will automatically end. The life of a home equity line of credit should be short (i.e., 5 to 10 years) again to enable the periodic reevaluation of the loan plan and to permit members to reassess their credit needs.

Entries in the Journal and Cash Record

All entries affecting this account should be recorded as "Miscellaneous" in the Journal and Cash Record.

Illustrative Entries

- a) To record the net origination fees (costs):

Dr.-Cash	\$1,000.00	
Cr.-Deferred Credits-Net Origination Fees (Costs)- Lines of Credits to Members		\$1,000.00

- b) To record the monthly amortization at the end of the accounting period:

Dr.- Deferred Credits-Net Origination Fees (Costs)- Lines of Credits to Mem- bers	\$41.67	
Cr.-Other Miscellaneous Operating Income		\$41.67

Detailed Transactions

Credit:

- With the fees received.
- With the amortization of net costs.
- With the unamortized net costs transferred to "Line of Credit to Members- Credit Cards".

Debit:

- With the direct costs incurred.
- With the amortization of net fees.
- With the unamortized net fees transferred to "Line of Credit to Members- Credit Cards".

Deferred Credits-Net Origination Fees (Costs)-Home Equity Lines Of Credit

Deferred Credits-Net Commitment Fees (Costs)-Lines Of Credit To Members

Fees charged for entering into an agreement to make a loan, i.e., letters of credit, should be credited to this account. Direct loan origination costs incurred to make a commitment to originate a loan should be debited to this account. The net commitment fees should be deferred. If the commitment is exercised, the net fees should be amortized into income on a straight-line basis over the life of the contract. Account "Service Income-Net Commitment Fees" should be used to recognize this income. If the commitment expires unexercised, the net fees should be recognized in income upon expiration.

If the enterprise's experience with similar arrangements indicates that the likelihood is slight that the commitment will be exercised, the net fees should be recognized over the commitment period on a straight-line basis as service fee income. If the commitment is subsequently exercised, the remaining unamortized fees should be amortized on a straight-line basis over the contract period.

If the borrower pays all borrowings and cannot re-borrow under the contract, any unamortized net fees should be recognized in income upon payment. If the borrower has the option of converting the line of credit to a term loan, the straight-line method should be applied to the combined life of the line of credit and term loan. If the option is exercised the unamortized net fees should be transferred to "Net Commitment Fees (Costs)Loans to Members."

Once in the contra account, the net fees should be amortized into income based on the interest method. If the option is not exercised and no borrowings are outstanding, the net fees should be recognized in income.

If the commitment fee is determined retrospectively as a percentage of the line of credit available but unused in a previous period, if that percentage is nominal in relation to the stated interest rate on any related borrowing, and if that borrowing will bear a market interest rate at the date the loan is made, the commitment fee should be recognized as service income as of the determination date.

Entries in the Journal and Cash Record

All entries affecting this account should be recorded as "Miscellaneous" in the Journal and Cash Record.

Illustrative Entries

- a) To record the net commitment fees received from a member:

Dr.-Cash	\$1,000	
Cr.-Deferred Credit-Com-		
mitment Fees (Costs)- Lines		
of Credit to Members		\$1,000

- b) Assuming the commitment is exercised, the periodic amortization would be recorded as follows:

Dr.- Deferred Credit-Com-
mitment Fees (Costs)- Lines of

Credit to Members	\$100
Cr.-Service Income-Net	
Commitment Fees (Costs)	\$100

- c) Assuming the commitment expires unexercised, the entry would be:

Dr.- Deferred Credit-Com-		
mitment Fees (Costs)-		
Lines of Credit to Mem-		
bers	\$1,000.00	
Cr.-Service Income-Net		
Commitment Fees (Costs)	\$1,000.00	

Detailed Transactions

Credit:

- a) With the amount of fees received.

Debit:

- a) With the amount of direct costs incurred.
- b) With the period amortization of net fees.
- c) With the amount of net fees when the commitment expires unexercised.
- d) With the amount of unamortized net fees when the option to convert to a term loan is exercised.

Deferred Credits-Net Commitment Fees (Costs)-Loans To Members

Fees charged for entering into an agreement to make a loan should be credited to this account. Direct loan origination costs incurred to make a commitment to originate a loan should be debited to this account. The net commitment fees should be deferred. If the commitment is exercised, this account should be debited and the appropriate loan contra account for net commitment fees should be credited. The net fees should then be recognized as income over the life of the loan using the interest method. If the commitment expires unexercised, the net fees should be recognized as income upon expiration.

If the enterprise's experience with similar arrangements indicates that the likelihood is slight that the commitment will be exercised, the net fees should be recognized over the commitment period on a straight-line basis as service fee income. If the commitment is subsequently exercised, the remaining unamortized fees should be transferred to "Net Commitment Fees (Costs)-Loans to Members" and recognized as income over the life of the loan using the interest method.

SUSPENSE ACCOUNTS

Unapplied Data Processing Exceptions

The accounts in this series are provided for credit unions using computers for the processing of accounting transactions. The accounts are used to show the amount of unprocessed transactions rejected by the computer because of error or invalid input data. Examples are transactions bearing incorrect account numbers or names, an incorrect transaction date, a transaction designated as a loan repayment when no outstanding loan to the member is contained in the computer files, etc.

Two accounts are provided in this series for processing exceptions relating to receipt and disbursement transactions, respectively. As an alternative both unapplied disbursements may be recorded in "Unapplied Data Processing Exceptions". Exceptions must be corrected and submitted promptly for posting after a listing of exceptions has been received.

Unapplied Data Processing Exceptions (Receipts)

This account reflects amounts of transactions rejected by the computer representing receipts which have not yet been applied. When the credit union receives an exception listing, an adjusting entry should be recorded in the Journal and Cash Record. The amount of unapplied receipts should be entered in the Journal and Cash Record as a credit to this account. The offsetting debit should be to the account(s) to which the rejected transactions were originally credited, which in some cases could be to the "Undistributed" accounts under "Accounts Payable".

When the unapplied exception is corrected, the adjustments made upon receipt of the exception listing should be reversed in the Journal and Cash Record as of the date of re-submittal to the computer.

Entries in the Journal and Cash Record

All entries to this account should be recorded as "Miscellaneous" in the Journal and Cash Record unless the credit union establishes separate columns for such transactions because of the volume of debits and credits affecting this account.

Illustrative Entries

-
- a) Upon receipt of an exception showing unapplied collections:

Dr.-Loans	\$1,400	
Dr.-Interest on Loans	45	
Cr.-Unapplied Data Processing Exceptions (Receipts)		\$1,445

Note: If the credit union credits items sent to the computer for processing to an "Undistributed" account in the Accounts Payable series, the debit above would be to that account.

- b) When exceptions are corrected and resubmitted to the computer, the entry shown above should be reversed.
-

Detailed Transactions

Credit:

- a) With amounts of unprocessed receipt transactions rejected by the computer and shown on exception listings.

Debit:

- a) With amounts of rejected receipt transactions resubmitted to the computer for processing.

Unapplied Data Processing Exceptions (Disbursements)

This account is used to record disbursement transactions that were rejected by the computer. When the credit union receives an exception listing, this account is debited and the offsetting credit goes to reverse the original entry or entries. When the unapplied exceptions are corrected, which should be timely, the entries made above should be reversed as of the date resubmitted to the computer.

Entries in the Journal and Cash Record

All entries to this account should be recorded as "Miscellaneous" in the Journal and Cash Record unless the credit union establishes separate column(s) for such transactions because of the volume of transactions affecting this account.

Illustrative Entries

- a) Upon receipt of an exception listing showing unapplied disbursements:

Dr.- Unapplied Data Processing Exceptions (Disbursements)	\$310	
Cr.-Loans		\$250
Cr.-Shares		60

- b) When exceptions are corrected and resubmitted to the computer, the entry shown above should be reversed.

Detailed Transactions

Debit:

- a) With amounts of unprocessed disbursement transactions rejected by the computer and shown on exception listings.

Credit:

- a) With amounts of rejected disbursements transactions resubmitted to the computer for processing.

COMMITMENTS AND CONTINGENT LIABILITIES

Accrued Loss Contingencies

This account is used to accrue a loss from a loss contingency when both of the following conditions exist:

- It is probable that an asset has been impaired or a liability has been incurred; and
- The amount of the loss can be reasonably estimated.

A loss contingency is defined as an existing condition, situation, or group of circumstances that involve uncertainty as to possible gain or loss to a credit union. It is resolved when one or more future events takes place or fails to occur. When the uncertainty is removed, it may confirm the purchase of an asset or the reduction of a liability or the incidence of a loss, impairment of an asset, or a liability. Examples of such contingencies would be:

- Pending or threatened litigation;
- Guarantees of indebtedness to others;
- Risk of loss or damage to credit union property by fire, explosion, flood, or other hazards which are not insurable;
- Agreements to repurchase loans, property, or other receivables that have been sold;
- Obligations of credit unions under standby letters of credit; and
- Actual possible claims and assessments.

Entries in the Journal and Cash Record

The entries to this account are recorded as "Miscellaneous" in the Journal and Cash Record. The offsetting changes to expenses should be recorded in the separate column designated for operating expense debits.

Illustrative Entries

a) To record an accrual for a loss contingency that will result from uninsured medical expenses of a credit union member. The member fell on the icy outside steps of the credit union office and has filed a lawsuit against the credit union to recover medical expenses. The credit union's attorney believes that the credit union will incur the loss. The credit union's uninsured portion of the loss will be \$10,000. The court case is expected to be finalized in three months. The entry to record estimable or probable loss would be:

Dr.-Miscellaneous	
Operating Expenses	\$10,000
Cr.-Accrued Losses	
Contingencies	\$10,00000

The above entry would be made as of the balance sheet date.

Detailed Transactions

Credit:

a) With amounts of periodic changes to expenses representing unpaid costs in order to allocate such costs over the period to which they apply.

Debit:

a) With the amounts recorded to this account when the losses are paid; adjustments to the accrual amounts should be charged or credited as applicable to this account and the appropriate expense account.

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MEMBERS' SHARES

Federal credit unions are empowered to issue share accounts at varying dividend rates and share certificates at varying dividend rates and maturities, subject to rates, terms, and conditions as established by a credit union's board of directors. Section 701.35 of the National Credit Union Administration Rules and Regulations provides flexibility to allow each federal credit union to develop a system of share accounts and share certificate accounts of its members.

The following are the account titles which can be used for the various types of share accounts:

Regular Shares

Share Drafts
Club Accounts
Other Shares
Escrow Accounts
IRA/Keogh Retirement Accounts
Share Certificates of Deposit
Unposted Payroll Deduction Shares
Public Unit Shares
Money Market Shares, and
Shares of Nonmembers

Additional sub-accounts of the Regular Shares account may be established and assigned the next account number in the sequence that the credit union has established.

The National Credit Union Administration Rules and Regulations Part 707 address the required disclosures for share accounts.

DEMAND DEPOSITS

Demand deposits are accounts that may bear interest (dividends) and that the depositor is entitled to withdraw at any time without prior notice.

Demand deposits equate to Share Drafts accounts in most credit unions.

Share Draft Accounts

Traditionally, a Share Draft account is an account from which the holder is authorized to withdraw shares by means of a negotiable or transferable instrument or other order. In order to facilitate monitoring for reporting purposes, any account that is accessible by draft, except for "Money Market Shares" needs to be included in this account classification. The account should represent the total of all individual Share Draft accounts as shown on the separate Individual Share and Loan Ledger subsidiary records. The board of directors may declare dividends on such accounts as provided in the Federal Credit Union Act.

Entries in the Journal and Cash Record

All entries affecting this account should be recorded in the Journal and Cash Record; unused Journal and Cash Record columns may be used or the credit union may use the Journal and Cash Record Continuation Sheet.

Posting to the General Ledger

Debits and credits to this account in the General Ledger are made by posting the totals of the Share Draft accounts columns of the Journal and Cash Record at the end of each month.

Posting to Members' Accounts

The individual items which are accumulated in the debit column of the Journal and Cash Record for Share Draft accounts for monthly posting to the General Ledger, should also be recorded on the Individual Share and Loan Ledger and in the Member's Passbook or Statement of Account. Credit entries for deposits to the share draft accounts should be recorded from Cash Received Vouchers; other credit entries should be posted from appropriate Journal Vouchers.

Balancing Individual Share Draft Accounts

The total of the individual share draft accounts, as shown in the Individual Share and Loan Ledgers, should be proved with the "Share Draft Accounts" in the General Ledger at least monthly and the listings retained in the files.

Illustrative Entries

- a) When a member opens an account or makes a deposit to a Share Draft account:

Dr. -Cash	\$200.00	
Cr.-Share Draft Accounts		\$200.00

- b) When a transfer is made from another share account to replenish a Share Draft account or to clear an overdraft:

Dr.-Shares	\$50.00	
Cr.-Share Draft Accounts		\$50.00

- c) When an overdraft is cleared through a line of credit:

Dr.-Lines of Credit to		
Members	\$50.00	
Cr.-Share Draft Accounts		\$50.00

- d) When a charge is made for issuing drafts to a member:

Dr.-Share Draft Accounts	\$6.00	
Cr.-Miscellaneous Fee Income		\$6.00

e) When a Share Draft is cleared and posted to a member's account:

Dr.-Share Draft Accounts	\$75.00
Cr.-Cash-Share Draft Settlement Account.	\$75.00

Detailed Transactions

Credit:

- a) With amounts received from share deposits.
- b) With amounts transferred from another share account.
- c) With amounts transferred from a line of credit.
- d) With amounts of dividends applied.

Debit:

- a) With drafts that clear through the Share Draft settlement account.
- b) With service charges, such as costs to issue drafts to members.

SAVINGS DEPOSITS

Savings deposits bear interest and have no stated maturity.

Savings deposits include the following types of accounts:

- Regular Share Accounts
- Money Market Shares
- Other Share Accounts
- Escrow Accounts
- Unposted Payroll Deductions Shares
- Public Unit Shares
- Shares of Nonmembers

Regular Share Accounts

Federal credit unions must make available to its members a share account which does not require the holder to maintain a minimum balance greater than the stated par value of one share. This account confers ownership rights to the member and provides for continued membership in the credit union. This type of share account is defined as a "Regular Share Account." The board of directors of any federal credit union may establish Regular Share accounts with varying dividend rates. Every type of share account need not receive the same dividend rate, and accordingly, federal credit unions are authorized to value the dividend rates on different Regular Share accounts, provided the rates are established and paid in a non-discriminatory manner. However, all accounts within a participating class must receive identical treatment.

Regular Shares represents the total of all members' Regular Share accounts as shown on the Individual Share and Loan Ledgers.

Entries in the Journal and Cash Record

This account is credited as "Shares Paid In" with amounts collected from members as shown on summary vouchers which represent payments on shares, and with dividends and interest refunds credited to members share accounts. This account is debited as "Shares Withdrawn" when amounts are withdrawn or applied on amounts due the credit union.

Posting to the General Ledger

Debits and credits to this account in the General Ledger are made by posting the totals of "Shares" from the Journal and Cash Record at the end of each month.

Illustrative Entries

-
- a) When payments on shares and entrance fees

are received from members:

Dr.-Cash	\$10.00	
Cr.-Regular Shares		\$8.00
Cr.-Fees and Charges		2.00

b) When a member withdraws from his share account:

Dr.-Regular Shares	\$20.00	
Cr.-Cash		\$20.00

c) When a member authorizes the credit union to apply his shares to his outstanding loan:

Dr.-Regular Shares	\$50.00	
Cr.-Loans		\$49.00
Cr.-Interest on Loans		1.00

Detailed Transactions

Credit:

- a) With amounts received for share purchases.
- b) With amounts of dividends and interest refunds applied toward the purchase of shares.

Debit:

- a) With amounts of withdrawals from share accounts.
- b) With amounts of shares applied on outstanding loans.

Entries in Member's Passbook

All payments on and withdrawals of shares must be entered in the Member's Individual Share Ledger and on the Member's Passbook or Statement of Account at the time of the receipt of the cash or cash disbursement.

Postings to Individual Share and Loan Ledger

The items which are accumulated as "Shares Withdrawn" in the Journal and Cash Record are recorded individually in the member's account on

the Individual Share and Loan Ledger "Shares Paid In" entries are made in the Individual Share and Loan Ledger from the Cash Received Voucher.

Balancing Individual Share Accounts

The total of the individual Share account balances as shown in the Individual Share and Loan Ledgers should be balanced with the "Regular Shares" in the General Ledger at least monthly and the trial balance listings (adding machine tapes or computer trial balance must be retained).

Money Market Shares

This account represents the total of all the individual money market share accounts as shown on the separate Individual Share and Loan Ledger subsidiary records established for money market shares.

Generally, a Money Market Share account is a short-term, draft account designed to pay competitive money market rates.

The specific terms and conditions are determined by the board of directors of the credit union.

Entries in the Journal and Cash Record

All entries affecting this account should be recorded in the Journal and Cash Record columns; unused "Journal and Cash Record" columns may be used or the credit union may use the Journal and Cash Record continuation Sheet.

Posting to the General Ledger

Debits and credits to this account in the General Ledger are made by posting the totals of the "Money Market Share Accounts" column of the Journal and Cash Record at the end of the month.

Posting to Members' Accounts

The individual items which are accumulated in the Journal and Cash Record for Money Market Shares Accounts, for monthly posting to the General Ledger, should also be recorded on the Individual Share and Loan Ledger and in the

Member's Passbook or Statement of Account. Credit entries for deposits to the Money Market Share Accounts should be recorded from Cash Received Vouchers; other credit entries should be posted from the appropriate Journal Vouchers.

Balancing Individual Money Market Share Accounts

The total of the individual Money Market Share Accounts as shown in the Individual Share and Loan Ledgers should be proved with the "Money Market Share Accounts" in the General Ledger at least monthly and the listings retained in the files.

Illustrative Entries

- a) When payments on Money Market Shares are received:

Dr.-Cash	\$10,000.00
Cr.-Money Market Shares	\$10,000.00

- b) When dividends are applied to member's Money Market Shares earning a daily dividend:

Dr.-Dividends Payable	\$2.00
Cr.-Money Market Shares	\$2.00

- c) When a Money Market Share Draft is cleared and posted to a member's account:

Dr.-Money Market Shares	\$502.00
Cr.-Cash-Money Market Draft Settlement	\$502.00

- d) When Money Market Shares are withdrawn (paid to the member):

Dr.-Money Market Shares	\$9,500.00
Cr.-Cash	\$9,500.00

Detailed Transactions

Credit:

- With amounts received from share deposits.
- With amounts transferred from another share account.
- With amounts of dividends added to the account.

Debit:

- With amounts of withdrawals from the account paid to the member.
- With amounts of penalties charged if the account is withdrawn under the minimum balance requirement.
- With drafts that clear through the money market share settlement account.

Other Share Accounts

This account represents the balance of share accounts for which no other provision is made.

Examples include the following:

- A notice account is an account which requires the holder to give written notice of the intent to withdraw.
- A minimum balance account is an account which requires the holder to maintain a specified balance in the account for at least an entire dividend period. The board of directors can establish any minimum balance they choose.
- A split rate account is an account which earns dividends at a different rate on the portion of the balance above a certain minimum requirement.

Further valuations may be established. The board of directors may declare dividends on such ac-

counts as provided for in Section 117 of the Federal Credit Union Act.

Escrow Accounts

If escrow accounts are required and the borrower is a member, the escrow account should be maintained as a special limited withdrawal share account. The escrow account should provide for the accumulation of funds to pay for not more than one year's taxes, assessments, insurance premiums, or other charges that could affect the credit union's first lien position. At the time the account is opened, the member-borrower should be required to sign a blanket withdrawal authorization which permits the FCU to use the funds to make the required payments. The FCU should also arrange with each borrower for whom an escrow account is maintained to promptly submit to the FCU for payment, any statements received by the borrower relating to taxes, assessments, insurance premiums and other fees which are to be paid from the escrow account. Any disbursement made from an escrow account should be supported by such documents.

Shares in escrow accounts may not be pledged as security for loans nor may any such shares be applied to loans which are delinquent. Withdrawals of the amount in excess of that amount required to pay the fees for which the account was established are permissible at any time. Other withdrawals, except to pay the fees for which the account was established are not permissible.

For dividend purposes an escrow account is considered a Regular Share account. This account should represent the total of all individual Share-Escrow Accounts as shown on the separate Individual Share and Loan Ledger subsidiary records. The balance on this account may be combined with the balance of "Regular Shares" for the preparation of the monthly financial reports.

Entries in the Journal and Cash Record

All entries affecting this account should be recorded as "Miscellaneous" in the Journal and Cash Record unless, because of volume, the credit union identifies as separate the credit and/or debit activity.

Posting to Members' Accounts

All payments to, and withdrawals from escrow accounts should be entered on the Member's Passbook or the member's Statement of Account at the time of the receipt or disbursement of cash.

Posting to the Individual Share and Loan Ledger

All receipts and disbursements on escrow accounts should be recorded individually in the member's account in the Individual Share and Loan Ledger. Shares Paid-In entries are made in the member's Passbook or the Member's Statement of Account and the Individual Cash Received Voucher; Shares Withdrawn entries are made from the Journal Voucher.

Balancing Individual Escrow Accounts

The total of the individual share accounts for escrow accounts as shown in the separate Individual Share and Loan Ledger should be proved with the "escrow account" in the General Ledger at least monthly and the listings retained in the files.

Illustrative Entries

- a) To record receipt of funds from settlement on real estate loan (hazard insurance-\$30; Mortgage insurance-\$20; Property Taxes-\$317):

Dr.-Cash	\$367.00
Cr.-Escrow Accounts	\$367.00

- b) To record payment of real estate property taxes from Escrow Account:

Dr.-Escrow Accounts	\$317.00
Cr.-Cash	\$317.00

Detailed Transactions

Credit:

- a) With amounts received at settlement on real estate loan.
- b) With amounts received from a real estate borrower on a periodic basis.

Debit:

- a) With amounts for payment of taxes, insurance, etc., for which the Escrow Account was established.
- b) With withdrawals of amounts in excess of the amount required to pay fees for which the account was established.

Unposted Payroll Deductions

This account is used for processing payroll deductions made from members' paychecks by their employer(s). This account should represent the accumulated amount of payroll deductions not yet distributed to "Regular Shares," "Loans," and "Interest on Loans," etc. Any amount in this account at month end should be combined with the amount in "Regular Shares" in the monthly financial report.

Entries in the Journal and Cash Record

All entries affecting this account should be recorded as "Miscellaneous".

Detailed Transactions

Credit:

- a) With the total of each periodic payroll deduction received.

Debit:

- b) With the total of payroll deductions previously credited to this account when applied to appropriate accounts; e.g., "Regular Shares", "Loans", "Interest on Loans", etc.

Public Unit Shares

A *public unit account* represents share deposits made by a governmental unit, e.g., city, county and so on as authorized by Section 107(6) of the Federal Credit Union Act and defined in Part 745.1 of the NCUA Rules and Regulations. These accounts could be regular share, share draft, or share certificate accounts. Normally, these accounts are of a highly volatile nature and the credit union needs to use caution in managing them. Refer to Parts 701.32 and 745.10 of the NCUA Rules and Regulations for more information.

If funds are received from more than one public unit, separate ledgers shall be maintained for each unit. For accounting purposes, public funds will be entered in the General Ledger under Shares-Public Unit Accounts.

Entries in the Journal and Cash Record

All entries affecting this account should be recorded as "Miscellaneous" in the Journal and Cash Record unless, because of volume, the credit union identifies as separate the credit and/or debit activity.

Posting to Members' Accounts

All payments and withdrawals on Public Unit Shares should be entered on the custodian's Passbook or the Statement of Account at the time of receipt or disbursement of cash.

Posting to the Individual Share and Loan Ledger

All payments by custodians on Public Unit Shares should be recorded individually in the

shareholder's account in the Individual Share and Loan Ledger. "Shares Paid In" entries are made in the Individual Share and Loan Ledger from the Cash Received Voucher.

Balancing Individual Public Unit Share Accounts

The total of the individual share accounts for Public Unit Shares as shown in the separate Individual Share and loan ledgers must be proved with this "Public Unit Shares" account in the General Ledger at least monthly and the listings retained in the file.

Illustrative Entries

- a) When payments on Public Unit Shares are received:

Dr.-Cash	\$60.00	
Cr.-Shares-Public Unit Accounts		\$60.00

- a) When dividends are applied to Public Unit Share Accounts:

Dr.-Dividends Payable	\$5.00	
Cr.-Shares- Public Unit Accounts		\$5.00

- a) When Public Unit Shares are withdrawn (paid to shareholder):

Dr.- Shares- Public Unit Accounts	\$125.00	
Cr.-Cash		\$125.00

Detailed Transactions

Credit:

- With amounts received for share purchase.
- With amounts of dividends applied toward the purchase of shares.

Debit:

- With amounts of withdrawals of Public Unit Shares.

Shares of Nonmembers

A *nonmember share account* represents the shareholdings of other federally insured credit unions and, in the case of credit unions serving predominantly low-income members, the shareholdings of nonmember individuals or organizations. Refer to Parts 701.32 and 701.34 of the NCUA Rules and Regulations for more information.

Each share account must be maintained on an Individual Share Ledger record and must be kept separate from the members' individual share accounts.

Entries in the Journal Cash Record

Transactions involving this account should be maintained separately from the Regular Share transactions recorded in the "Shares" columns. If there are a number of transactions each month, separation should be provided in the Journal and Cash Record. If there are relatively few transactions "Miscellaneous" grouping may be used.

Posting to Members' Accounts

All payments on shares and withdrawals of shares should be entered in the nonmember's passbook or the Statement of Account, at the time of the receipt or disbursement of cash.

Posting to the Individual Share and Loan Ledger

Share withdrawal items recorded in the Journal and Cash Record are also recorded individually in the nonmember's account in the Individual Share Ledger. Share Paid In entries are made in the nonmember's Individual Share Ledger from the Cash Received Voucher.

Balancing Individual Nonmember Share Accounts

The total of the individual nonmember share accounts as shown in their individual ledgers should be proved with the "Shares of Nonmembers" in the General Ledger at least monthly and the listing retained in the files.

Illustrative Entries

- a) When payments on shares are received from nonmembers:

Dr.-Cash	\$300.00
Cr.-Shares of Nonmembers	\$300.00

- b) When a nonmember withdraws from his share account:

Dr.-Shares of Nonmembers	\$250.00
Cr.-Cash	\$250.00

Detailed Transactions

Credit:

- a) With amounts received for share purchases.
b) With amounts of dividends applied toward the purchases of shares of nonmembers.

Debit:

- a) With amounts of withdrawals from share accounts by nonmembers.

TIME DEPOSITS

Time deposits bear interest for a fixed, stated period of time.

Time deposits include the following types of accounts:

IRA/Keogh Retirement Accounts

Share Certificates of Deposit
Club Accounts
Brokered Deposits

Ira/Keogh Retirement Accounts

Federal credit unions are free to design Individual Retirement Accounts (IRA) in any manner they choose, without any maturity or dividend ceiling restrictions. Members may be permitted to convert any share, share certificate, or share draft account to an IRA without penalty. Any taxpayer can open an IRA account.

The members should be advised to consult their tax advisers to determine the deductibility of their contributions. The credit union should refrain from offering tax advice.

This account represents the total of all individual share accounts established pursuant to Sections 401(d) and 408 of the Internal Revenue Code as shown on the separate Individual Share and Loan ledger subsidiary records. Shares in this account may not be pledged as security for loans nor may such shares be applied to loans which are delinquent. Withdrawals from these accounts are subject to restrictions as specified in the individual trust or custodial agreements.

The credit union in its capacity of trustee for these accounts must comply with certain reporting requirements as established by the Internal Revenue Code.

A properly-completed, duly-approved application for membership plus an initial payment into a share account established for retirement purposes under a trust or custodial agreement is sufficient to qualify for membership. A companion Regular Share account is not required for membership.

Entries in the Journal and Cash Record

All entries affecting this account should be recorded as "Miscellaneous" in the Journal and

Cash Record unless, because of volume, the credit union identifies separate grouping for the credit and/or debit activity.

Postings to Members' Accounts

All payments on Retirement Plan Shares and withdrawals should be entered on the member's Passbook or Statement of Account at the time of the receipt or disbursement of cash.

Posting to the Individual Share and Loan Ledger

All payments by members on Retirement Plan Shares should be recorded individually in the member's account in the Individual Share and Loan Ledger. Shares Paid In entries are made in the Share and Loan Ledger from the Cash Received Voucher.

Balancing Individual IRA/Keogh Retirement Accounts

The total of the individual share accounts for IRA/Keogh retirement plan shares as shown in the separate Individual Share and Loan ledgers should be proved with "IRA/Keogh Retirement Plan Shares" account in the General Ledger at least monthly and the listings retained in the files.

Illustrative Entries

- a) When payments on Retirement Plan Shares are received:

Dr.-Cash	\$60.00	
Cr.-Shares-Retirement Plans		\$60.00

- b) When dividends are applied to Retirement Plan Shares of members:

Dr.-Dividends Payable	\$5.00	
Cr.-Shares-Retirement Plans		\$5.00

- c) When Retirement Plan Shares are withdrawn (paid to member):

Dr.-Shares-Retirement Plans	\$125.00
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Cr.-Cash

\$125.00

Detailed Transactions

Debit:

- With amounts of withdrawals of retirement plan shares.
- With amounts of fees assessed for trusts or custodial services.

Credit:

- With amounts received for share purchases.
- With amounts of dividends applied toward the purchase of shares.

Share Certificates of Deposit

This account represents the total of all individual share certificate accounts as shown on the separate Individual Share and Loan Ledger subsidiary records established for the share certificates.

Entries in the Journal and Cash Record

All entries affecting this account should be entered separately in the Journal and Cash Record or Journal and Cash Record (Continuation Sheet).

Posting to Members' Accounts

All payments on Share Certificate accounts and withdrawals should be entered on the Member's Passbook or the Member's Statement of Account, at this time of the receipt or disbursement of cash.

Posting to the Individual Share and Loan Ledger

All payments and withdrawals by members on

Share Certificate accounts should be recorded individually in the member's certificate account in the Individual Share and Loan Ledger. Shares Paid In entries are made in the Individual Share and Loan Ledger from the Cash Received Voucher.

Balancing Individual Share Certificate Accounts

The total of the individual share certificate accounts for Share Certificates as shown in the separate Individual Share and Loan Ledger should be proved with the "Share Certificate" account in the General Ledger at least monthly and the listings retained in the files.

Illustrative Entries

- a) When payments on Share Certificates are received:

Dr.-Cash	\$10,000.00
Cr.-Share Certificates	\$10,000.00

- b) When dividends are applied to Share Certificates of members:

Dr.-Dividends Payable	\$700.00
Cr.-Share Certificates	\$700.00

- c) When Share Certificates are withdrawn (paid to member):

Dr.-Share Certificates	\$10,700.00
Cr.-Cash	\$10,700.00

Detailed Transactions

Credit:

- a) With amounts received for certificates purchase.
- b) With amounts of dividends added to the account.

Debit:

- a) With amounts of withdrawals from the certificates.
- b) With amounts of penalty charges for premature withdrawals.

Club Accounts

A credit union may, if the board of directors deems it desirable, permit more than one share account for each member. These additional accounts may be opened for certain purposes such as Christmas savings, vacations, and savings for an educational fund. The member retains full control over his/her Club accounts, as with a Regular Share account, subject to the terms and conditions set by the board of directors. If club accounts are used, they should be included with the member's Regular account in determining whether the shares held by him have exceeded the limit set by the board of directors. If a member is permitted to establish a club account, it should be indicated on the share trial balance and/or share ledger somewhat as follows:

"John Jones", Club Share Account.
The accounts should either be numbered consecutively such as Club Account No. 1, No. 2, etc., or be titled by the type of account, such as Christmas Savings, Share Account, Vacation Share Account, and so on.

The credit union may segregate the different valuations of Club Accounts in separate General Ledger accounts (i.e., for Christmas Savings and for Vacation Savings). The balances of these segregated Club accounts may be combined with the balance of "Regular Shares" for the preparation of the monthly financial reports. The balance of each segregated Club Account must equal the total of the individual accounts for each valuation of Club Account. The balancing should be done at least monthly.

Posting Payments and Withdrawals to Club Accounts

All entries affecting this account should be recorded in the Journal and Cash Record. Total debits and credits to this account in the General Ledger are made by posting the totals of the "Club Accounts" in the Journal and Cash Record at the end of each month. The individual payments on and withdrawals of club shares should also be entered in the member's Individual Share Ledger and on the Member's Passbook or Statement of Account at the time of the receipt or cash disbursement.

Brokered Deposits

Brokered deposits are third-party deposits placed by or with the assistance of a deposit broker. Deposit brokers sometimes sell interests in deposits placed with third-parties. Section 701.32(b) of the NCUA Rules and Regulations restricts nonmember accounts, including brokered deposits, to 20 percent of the total shares of a federal credit union, or \$1.5 million, whichever is greater.

Entries in the Journal and Cash Record

All entries affecting this account should be entered separately in the Journal and Cash Record or Journal and Cash Record (Continuation Sheet).

Posting to Members' Accounts

All payments on Brokered Deposit accounts and withdrawals should be entered on the nonmember passbook or the Statement of Account, at the time of the receipt or disbursement of cash.

Posting to the Individual Share and Loan Ledger

All payments and withdrawals on Brokered De-

posits accounts should be recorded individually in the nonmember's certificate account in the Individual Share and Loan Ledger. Shares Paid In entries are made in the Individual Share and Loan Ledger from the Cash Received Voucher.

Balancing Individual Brokered Deposits

The total of the individual brokered deposit accounts as shown in the separate Individual Share and Loan Ledger should be proved with the "Brokered Deposits" account in the General Ledger at least monthly and the listings retained in the files.

Illustrative Entries

a) When payments on Brokered Deposits are received:

Dr.-Cash	\$100,000	
Cr.-Brokered Deposits		\$100,000

b) When dividends are applied to Brokered Deposits of nonmembers:

Dr.-Dividends Payable	\$700	
Cr.-Brokered Deposits		\$700

c) When Brokered Deposits are withdrawn (paid to nonmember):

Dr.-Brokered Deposits	\$100,700	
Cr.-Cash		\$100,700

Detailed Transactions

Credit:

- a) With amounts received for brokered deposits.
- b) With amounts of dividends added to the account.

Debit:

- a) With amounts of withdrawals from the brokered deposits.

- b) With amounts of penalty charges for premature withdrawals.

DEFINITIONS

Share Account-refers to a regular share account and any other account that is not a share certificate account. A regular share account is an account that does not require a holder to maintain a balance greater than the par value and one that does not require notice of intent to withdraw, except as may be imposed in accordance with the Federal Credit Union Bylaws, and that qualifies for a dividend.

Share Draft Account-means an account from which the holder is authorized to withdraw shares by means of a negotiable or transferable instrument or other order.

Share Certificate Account-refers to an account that will earn dividends at a specified rate for a specified period of time, if held to maturity, upon which a penalty may be assessed for premature withdrawal prior to maturity.

Premature Withdrawal-refers to an early withdrawal of all or any portion of the principal amount of a share or share certificate account prior to its maturity. It also refers to the withdrawal of all or any portion of the principal amount prior to providing any required notice of withdrawal.

MICR stands for Magnetic Ink Character Recognition and refers to the numbering printed in magnetic ink at the bottom of each share draft.

Payable through bank means a bank that has been designated to make presentment of a share draft to the federal credit union for payment.

Payable at bank means a draft drawn on the credit union that is payable at any correspondent or Federal Reserve Bank. It is payable when it falls due out of any funds of the maker or acceptor. The bank is expected to make payment with-

out consulting the credit union. In this situation the draft is endorsed, "Payable at any bank" and it bears the routing and transit number of the credit union.

Truncation-means the original negotiable or transferable instrument is not returned to the drawer.

PROCESSING BASIC SHARE TRANSACTIONS

When Payments On Shares Are Received

When cash is received for payment on shares or share certificates, a Cash Received Voucher should be prepared for the date of receipt in the credit union office. The amount to be credited to the member's account(s) is written in the space opposite "Shares". The total cash received is written in the space opposite "Total" and should equal the actual cash received. The person who received the cash for the credit union should initial the voucher in the space opposite "Received by."

After the payment is entered in the member's passbook, the balance shown in the passbook should be entered in the proper spaces under "Member's Passbook Balances" on the Cash Received Voucher. This will serve as a comparison of the member's passbook with the credit union's records when posting to the Individual Share and Loan Ledger and will often disclose errors which may occur, thus saving time in balancing the individual share ledgers with the General Ledger Account, "Shares", at the end of the month.

When cash is received from a member with an accompanying Cash Received Voucher, the amount received should immediately be entered in the member's passbook which is then returned to the member. No further receipt is necessary.

Each item of cash received which involves a member's share draft and/or share certificate account should be posted individually from the Cash Received Voucher to the "Paid In" column

of the member's Individual Share Ledger account. To make posting easier, it is suggested that the Cash Received Vouchers be sorted in numerical order by account number. To assist in keeping track of what accounts have been posted, as each account is posted a check mark can be made in the space provided on the Cash Received Voucher.

When Shares Are Withdrawn

When a member wishes to withdraw some of his/her shares or share certificates, a Journal Voucher should be prepared. If the shares to be withdrawn are pledged as security on a loan and the shares remaining after the withdrawal would be less than the member's direct or indirect liability to the credit union, or if the member's loan or a loan for which he cosigned is delinquent, the form should be initialed by the chairman or secretary of the credit committee or a loan officer showing approval for the withdrawal. If any person cosigned a loan for which the member's shares are pledged, that person's approval should also be obtained before the shares are released. Otherwise, the cosigner may be relieved of liability on the cosigned loan. The cosigners can indicate their approval by signing on the space "Authorized or Approved By" on the Journal Voucher form. Some written evidence of the co maker's approval is essential.

The date and amount of the withdrawal should be entered in the member's passbook under the applicable headings "Shares", "Date" and "Withdrawn." The amount of withdrawal should be deducted from the balance and the new balance remaining in shares and/or share certificates should be entered in the column "Balance". The entry should be initialed by the person paying out the money for the credit union.

Each item of cash paid out which involves a member's share or share certificate account should be posted individually from the Journal and Cash Record or a Journal Voucher to the Individual Shares Ledger account of the member. A share withdrawal is posted as "Withdrawn" in the Shares Ledger and deducted from the previ-

ous share or share certificate balance. The new balance is identified as the new "Balance."

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MEMBERS' EQUITY

UNINSURED SECONDARY CAPITAL

Federally insured credit unions designated as low-income are authorized to establish secondary capital accounts. The increased capital is intended to enable those credit unions to support greater lending and improve other financial ser-

vices for the limited income groups and communities they serve. Certain restrictions are placed on these accounts, foremost among them is that the accounts may be *offered only to organizational investors*, not to natural person members or other natural person investors. Other key restrictions are:

- The accounts are not insured by the NCUSIF or any other government entity, and may not be offered as share accounts. They will take the form of subordinated debt.
- The funds in the accounts must be available to cover losses, after reserves and undivided earnings, but prior to liquidation.
- The accounts must have a minimum maturity of 5 years.
- The accounts may not be used as security on other obligations of the account holder.
- The accounts will not “carry over” as secondary capital in the event of merger into a credit union that is not low-income designated.

A declining scale for the capital value of accounts with less than 5 years remaining maturity has been established. All funds, however, will continue to be at risk to cover losses that exceed reserves and undivided earnings. Accounts with remaining maturities of at least:

- 4 years, but less than 5 years are counted as capital at 80 percent of face value;
- 3 years, but less than 4 years are counted as capital at 60 percent of face value;
- 2 years, but less than 3 years are counted as capital at 40 percent of face value;
- 1 year, but less than 2 years are counted as capital at 20 percent of face value; and
- less than one year remaining maturity will be counted as capital at 0 percent of face value.

A disclosure and acknowledgment must be provided and executed by an authorized representative of the account holder. State-chartered, federally insured credit unions may establish these accounts in accordance with the terms and conditions authorized for federal credit unions and to the extent they are not inconsistent with

applicable state law, regulation, and accounting requirements.

A regulatory accounting position (RAP) has been taken to establish these accounts and to recognize them as secondary capital. These accounts are subordinated debt and the account holder does not have voting or ownership rights. Credit unions should record the amount of secondary capital in the equity section of the balance sheet, although any secondary capital that has a remaining maturity of less than 5 years will be split into capital and liability components based on a sliding scale. To be consistent with generally accepted accounting principles (GAAP), the credit union's outside auditor may recognize accounts established as secondary capital as subordinated debt, and for financial statement presentation purposes, may reflect the entire balance in these accounts in the liability section of the balance sheet.

Credit unions must adopt a written plan for use of the funds in the accounts and subsequent liquidity needs to meet repayment requirements upon maturity.

The secondary capital accounts may not be established as share accounts and, therefore, will be considered a form of subordinated debt, in effect a borrowing. In most cases of borrowed funds, the stated interest rate is guaranteed contrary to dividends on share deposits for credit unions which are limited to the amount of funds available from earnings, both current and accumulated. The credit union should consider its ability to meet the interest payment obligation in light of its current and accumulated earnings. Interest payable on these accounts must be accrued at least monthly. The credit union should consider the effect on regular members' dividends when setting the interest rate or index for these accounts.

Section 107(9) of the Federal Credit Union Act limits a credit union's borrowing to 50 percent of its paid-in and unimpaired capital and surplus. The amount held in secondary capital accounts held by low-income credit unions is to be included in total borrowings for purposes of this limitation. Secondary capital accounts, plus any

other borrowings by the low-income credit union will not exceed the 50 percent limit.

Part 705 of the NCUA Rules and Regulations addresses the Community Development Revolving Loan Program for Credit Unions. A credit union participating in the program may receive up to \$300,000 in the form of a loan. A matching requirement encourages credit unions to develop a permanent source of *member shares* within one year of loan approval.

Accounts established as secondary capital by low-income designated credit unions may not be used as a source of matching funds for this program. First, secondary capital is not a *member share* and second, the regulation requires that the credit union maintain the increase in the total amount of *share deposits* for the duration of the loan from the program. These accounts “may not be offered as share accounts.”

Uninsured secondary capital accepted from a non-natural person investor should be recorded as follows:

Entries in the Journal and Cash Record

All entries affecting this account should be recorded as “Miscellaneous” in the Journal and Cash Record

Illustrative Entries

a) When a low-income designated credit union accepts a secondary capital account of \$100,000 with a 6-year maturity from a non-natural person investor:

Dr.-Cash	\$100,000
Cr.-Uninsured Secondary Capital	\$100,000

b) When the remaining maturity of the above account is between 4 and 5 years the following adjusting entry should be recorded to reflect only 80 percent of the account as secondary capital:

Dr.-Uninsured Secondary Capital	\$20,000
Cr.-Subordinated CDCU Debt	\$20,000

Note: In the event that a low-income credit union has depleted its reserves and undivided earnings and incurs an operating loss, the loss, as realized, will be distributed pro rata among the current secondary capital account holders. For example, a credit union has 5 secondary capital investors, each depositing \$100,000 for total secondary capital of \$500,000. The credit union incurs an operating loss of \$120,000; each account will be debited for \$24,000. The remaining balance in each account will be \$76,000, with a total remaining secondary capital of \$380,000. A credit union that has funds split between “Uninsured Secondary Capital” and “Subordinated CDCU Debt” should first absorb any pro rata loss from “Subordinated CDCU Debt”, with any remaining loss carried over to “Uninsured Secondary Capital”.

If a secondary capital account holder wishes to withdraw the investment at maturity, the credit union must determine losses as of the previous month end and allocate the loss, again on a pro rata basis to all account holders, prior to releasing the funds. Keep in mind that all funds will continue to be at risk to cover losses that exceed reserves and undivided earnings regardless of their capital values based on their final maturities.

REGULAR RESERVE

Consistent with requirements of the Federal Credit Union Act as amended by the Credit Union Membership Access Act (CUMAA) and implemented by the NCUA Board in its Rules and Regulations §702, a credit union must determine its net worth category classification at the end of each calendar quarter and subsequently set aside accumulated earnings in its Regular Reserve account. The net worth ratio calculation and mandated transfer requirements are discussed below.

Note: Risk based net worth requirements (RBNW) are not discussed in this Manual because this Manual is targeted to credit unions under \$10 million in assets; credit unions which are also excluded through rulemaking from the RBNW requirements. If a credit union's assets grow to over \$10 million, it should be aware additional RBNW transfers may be required. See the NCUA Rules & Regulations §702.

Net Worth Ratio Calculation

All credit unions must determine their net worth category classification at the end of each calendar quarter. Required transfers to the Regular Reserve are dependent on the net worth ratio calculation and related net worth classification.

The net worth ratio is calculated as:

Net Worth divided by *Total Assets*.

Net Worth. For purposes of this calculation, the "net worth" numerator is GAAP (generally accepted accounting principles) retained earnings consisting of undivided earnings, regular reserves, and any other appropriations of undivided earnings designated by management, regulatory authorities or the board. Appropriations are amounts which have flowed through the income statement to undivided earnings and then have been set aside in an appropriation for a given purpose. For low income-designated credit unions, by law, net worth also includes secondary capital

accounts that are uninsured and subordinate to all other claims.

Net worth includes amounts the credit union had previously closed from net income into undivided earnings. If the credit union does not close its net income into undivided earnings during interim periods, examiners will treat the net income as if it had been closed into undivided earnings.

Net worth does not include the:

- 1) Allowance for Loan & Lease Losses;
- 2) Contributions of tangible fixed-assets recorded as "Donated Equity" per regulatory accounting practice (RAP);
- 3) Unrealized Gains or Losses on Available for Sale Securities and/or other items of Other Comprehensive Income; or
- 4) Alternative sources of capital (e.g., paid-in-capital accounts), except that for low-income designated credit unions, net worth includes uninsured secondary capital accounts subordinate to claims of creditors, shareholders, and the NCUSIF. This exception applies only to low-income credit unions.

Total Assets. A credit union can choose its method for determining the "total assets" denominator as measured by one of the following:

- 1) Average quarterly balance - the average of quarter-end balances of the four most recent calendar quarters; or
- 2) Average monthly balance - the average of month-end balances over the three calendar months of the calendar quarter; or
- 3) Average daily balance - the average daily balance over the calendar quarter; or
- 4) Quarter-end balance - the quarter-end balance of the calendar quarter as reported on the credit union's quarterly call report and as calculated on the PCA worksheet.

For each quarter, credit unions will elect which method of determining total assets they will use for that specific quarter to determine the net worth ratio and, if applicable, the earnings transfer and asset growth restriction. This method also applies in the determination of whether or not a credit union is a new credit union. It does not apply to risk-based net worth for complex credit unions.

Calculation Effective Date

The effective date of the credit union's net worth category classification is the most recent of the following:

- 1) The last day of the calendar month following the end of the calendar quarter; or
- 2) The date the credit union's net worth ratio is recalculated by or as a result of its most recent final examination report; or

- 3) The date the credit union received written notice from NCUA or, if state-chartered, the appropriate State official, of reclassification on safety and soundness grounds as provided under §702.102(b) or §702.302(d).

Statutory Net Worth Categories

Illustration 3-A below shows the net worth categories for all credit unions. The left side shows net worth categories for credit unions other than those defined as new. The right side shows net worth categories for credit unions defined by statute as new (less than 10 years in operation and less than \$10 million in assets).

One must recognize that new credit unions initially have no net worth and that they need reasonable time in which to accumulate it. Illustration 3-B is an example of a reasonable (although not a mandatory) timetable for building net worth.

Other Than New Credit Unions

New Credit Unions

Net Worth Category	Net Worth Ratio		Net Worth Category	Net Worth Ratio
Well Capitalized	7% or greater		Well Capitalized	7% or greater
Adequately Capitalized	6% to 6.99%		Adequately Capitalized	6% to 6.99%
Undercapitalized	4% to 5.99%		Moderately Capitalized	3.5% to 5.99%
First Tier	5% to 5.99%		Marginally Capitalized	2% to 3.49%
Second Tier (and failed RBNW)	4% to 4.99%		Minimally Capitalized	0% to 1.99%
Significantly Undercapitalized	2% to 3.99%		Undercapitalized	Less than 0%
Critically Undercapitalized	Less than 2%			

Illustration 3-A

Reasonable Timetable to Build Net Worth

Within # of Years in Operation	Net Worth Ratio
3 Years	0% to 1.99%
5 Years	2% to 3.49%
7 Years	3.5% to 5.99%
10 Years	6% to 6.99%

Illustration 3-B

Earnings Transfers

Quarterly earnings transfers from Undivided Earnings to the Regular Reserve are mandated by implementing NCUA Rules and Regulations. Beginning with the effective date of classification as "adequately capitalized" or lower, a federally-insured credit union must transfer an amount equivalent to at least 1/10th percent (0.1%) of its total assets for the current quarter (or more by choice) from Undivided Earnings to its Regular Reserve account until it is "well-capitalized".

Entries in the Journal and Cash Record

All increases and decreases to the Regular Reserve are credited and debited as "Miscellaneous".

The Regular Reserve account should be increased (credited):

a) At the end of the accounting period with the amount of Undivided Earnings required to be transferred to the Regular Reserve (i.e., an amount equivalent to 1/10th percent of total assets until the credit union's net worth classification category reaches "well capitalized".)

The Regular Reserve account should be decreased (debited) with:

a) Other losses provided that either the charge will not cause the credit union's net worth classification to fall below "well capitalized" or the

charge has been previously approved in writing by the appropriate Regional Director, or if state-chartered, the appropriate state official.

b) A transfer of funds to "Undivided Earnings" to pay dividends if the credit union has depleted its "Undivided Earnings", provided that either the charge will not cause the credit union's net worth classification to fall below "well capitalized" or the charge has been previously approved in writing by the appropriate Regional Director, or if state-chartered, the appropriate state official.

Posting to the General Ledger

All debit and credit entries are posted from "Miscellaneous" in the Journal and Cash Record to the General Ledger. All entries must be explained in the "Explanatory Remarks" section of the General Ledger.

Illustrative Entries

At the close of the accounting period:

a) To transfer the required amount of earnings to the Regular Reserve:

Dr.-Undivided Earnings	\$800	
Cr.-Regular Reserve		\$800

Detailed Transactions

Credit:

At the end of the accounting period:

- a) With amount of earnings transfer required by statute and rule as amended; offsetting debit to "Undivided Earnings."

Debit:

At the end of the accounting period:

- a) With amount of other losses provided that either the charge will not cause the credit union's net worth classification to fall below "well capitalized" or the charge has been previously approved in writing by the appropriate Regional Director, or if State-Chartered, the appropriate state official; offsetting credit to "Undivided Earnings".
- b) With the amount necessary to pay dividends if the credit union has depleted its "Undivided Earnings", provided that either the charge will not cause the credit union's net worth classification to fall below "well capitalized" or the charge has been previously approved in writing by the appropriate Regional Director, or if State-Chartered, the appropriate state official; offsetting credit to "Undivided Earnings".

Special Reserve

Each federally-insured credit union shall establish and maintain such reserves as may be required by the Federal Credit Union Act, by state law, by regulation, or in special cases by the NCUA Board or appropriate State official. Specific accounting instructions pertaining to this account are furnished by the National Credit Union Administration when the "Special Reserve" is or-

dered. This account should not be used unless ordered or authorized by the National Credit Union Administration.

Entries in the Journal and Cash Record

All entries affecting this account should be recorded in the "Miscellaneous" columns of the Journal and Cash Record.

UNDIVIDED EARNINGS

This account is used to show the balance of the accumulated earnings of the credit union for prior periods and the earnings of the period just closed which are available for dividends.

The Undivided Earnings account should be increased (credited) with:

- a) The net earnings transferred at the end of each accounting period from the "Net Income (Loss)" account.
- b) The amount transferred from "Special Reserve for Losses", when this reserve is reduced or eliminated.
- c) The amount transferred from "Reserve for Loss Contingencies", when this reserve is reduced or eliminated.
- d) The amount transferred from "Appropriated Undivided Earnings", when this account is reduced or eliminated.
- e) The determined conversion amount for accrued income when converting to the Accrual Basis of Accounting (the debit side of this entry is to the accrued income account series.)

The Undivided Earnings account should be reduced (debited) with:

- a) The amount of the net loss transferred at the end of the accounting period from the "Net Income (Loss)" account.

- b) At the end of each accounting period, the required earnings transfer to the "Regular Reserve".
- c) The amount transferred to any Special Reserve for Losses which may be required by the NCUA Board.
- d) The amount transferred to "Reserve for Losses Contingencies".
- e) The determined conversion amount for accrued expenses when converting to the Accrual Basis of Accounting (the credit side of this entry is to the accrued expenses account series).
- f) The amount transferred to "Appropriated Undivided Earnings".

Expenses incurred or paid should not be charged directly to the Undivided Earnings account but must be charged to the appropriate expense accounts during the period they are incurred or paid. Likewise, income should not be credited directly to this account but credited to the appropriate income accounts. Bonuses to employees are not to be charged to this account but are to be considered as expenses. Dividends are also considered as expenses and charged to "Dividends Expense". Interest refunds are considered as reductions of income and credited to "Interest Refunds".

Entries in the Journal and Cash Record

All of the debit and credit entries to this account should be entered as "Miscellaneous" in the Journal and Cash Record.

Illustrative Entries

- a) To close period net income into Undivided Earnings:

Dr.-Net Income	\$5,000	
Cr.- Undivided Earnings		\$5,000

- a) To establish an appropriation of Undivided Earnings for a board-established purpose:

Dr.-Undivided Earnings	\$2,000	
Cr.- Appropriation for Building Fund		\$2,000

Detailed Transactions

Credit:

- a) At the end of the accounting period, with the net earnings transferred from "Net Income (Loss)".
- b) With transfers to reduce or eliminate the "Special Reserve for Losses" when authorized by the National Credit Union Administration Board.
- c) With transfers from the "Reserve for Loss Contingencies" or other reserves when authorized by the board of directors.
- d) With the determined conversion amount for accrued income when converting to the Accrual Basis of Accounting immediately following the closing of the books at the end of the dividend period.

Debit:

- a) At the end of the accounting period with net loss for the period transferred from "Net Income (Loss)".
- b) With the required earnings transfer to the Regular Reserve for the accounting period.
- c) With transfers to establish or increase the "Reserve for Loss Contingencies" (or other reserves) when authorized by the board of directors.
- d) With the determined conversion amount for Accrued Expense when converting to the Accrual Basis of Accounting immediately following the

closing of the books at the end of the dividend period.

Appropriated Undivided Earnings

This account may be established by any credit union, with the approval of the board of directors, for planned expenditures or liabilities, not otherwise shown on the credit union's records. This account should represent a further allocation of Undivided Earnings. It should be included in the equity section of the Statement of Financial Condition. Even though an Appropriated Undivided Earnings account has been established for a particular liability or expenditure, such as future dividend costs, relocation costs for moving to a new building or costs incurred for parking lot resurfacing, etc., expenditures of this nature should not be charged directly to this account. Rather, they should be charged to their respective expense accounts and included in the "Operating Expenses (Control)", or the respective General Ledger expense account balance total that is closed to "Undivided Earnings". Past earnings should be transferred from "Appropriated Undivided Earnings" to "Undivided Earnings" in amounts equal to the appropriated cost charged to the current period expenses during the accounting period. This will eliminate any reduction in Undivided Earnings that would have resulted from the charge to expenses.

Entries in the Journal and Cash Record

All of the debit and credit entries to this account should be entered as "Miscellaneous" in the Journal and Cash Record.

Posting to the General Ledger

Entries to this account in the General Ledger should be posted individually as "Miscellaneous" in the Journal and Cash Record.

Illustrative Entries

a) To establish, or increase the balance of, the Appropriated Undivided Earnings account when determined necessary by the board of directors:

Dr.-Undivided Earnings	\$5,000	
Cr.-Appropriated Undivided Earnings		\$5,000

b) To eliminate, or decrease balance of the Appropriated Undivided Earnings when determined to be necessary by the board of directors or to reimburse Undivided Earnings for planned expenditures or an incurred liability.

Dr.-Appropriated Undivided Earnings	\$2,500	
Cr.-Undivided Earnings		\$2,500

Detailed Transactions

Credit:

a) As authorized by the board of directors with amounts to be established, for a specific expenditure or liability, as Appropriated Undivided Earnings and with authorized increases in this account.

Debit:

a) As authorized by the board of directors with amounts of expenditures incurred that were included in operating expenses and resulted in a further reduction of the Appropriated Undivided Earnings Account.

Reserve for Loss Contingencies

The board of directors has the power, after the required Regular Reserve transfer requirements have been set aside, to provide for probable losses by establishing a "Reserve for Loss Contingencies". A Reserve For Loss Contingencies may only be established when it is probable that an asset has been impaired or a liability has been incurred at the date of the financial statements, future events will confirm the existence of the loss, and the loss can be reasonably estimated. Contingent losses not otherwise shown on the credit union's records should be recorded for amounts equal to those portions of the probable loss. Since the approximate date of the loss will probably be known, the expense may be accrued prior to the payment of the loss. This is accomplished by debiting the appropriate current period

expense account and crediting a liability account "Accrued Loss Contingencies" for an equivalent amount. At the same time, Undivided Earnings can be debited for a like amount and the Reserve for Loss Contingencies appropriation established.

The amount of the liability accrual will need to be adequate enough to allow the accrued liability account to equal the amount of the estimated loss at the time payment is expected to be made. Losses should not be charged directly against the "Reserve for Loss Contingencies". After the loss has been paid and charged against the accrued liability account, the designated Reserve for Loss Contingencies balance should be eliminated and "Undivided Earnings" credited for a like amount at the end of the dividend period.

This account should also be used in cases where the deductible on the federal credit union's fidelity bond exceeds 10 percent of the federal credit union's Regular Reserve account.

This account should only be increased with amounts necessary to maintain the difference between the deductible and 10 percent of the Regular Reserve Account. The amount of such excess should be credited to this account with an offsetting debit to "Undivided Earnings". The account should be eliminated when the deductible becomes less than or equal to 10 percent of federal credit union's Regular Reserve account. This is accomplished by debiting this account and crediting "Undivided Earnings".

Entries in the Journal and Cash Record

All entries affecting this account should be recorded as "Miscellaneous" in the Journal and Cash Record.

Illustrative Entries

a) To establish, or increase the balance of, a Reserve for Loss Contingencies when determined necessary by the board of directors:

Dr.-Undivided Earnings	\$5,000
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Cr.-Reserve for Loss Contingencies	\$5,000
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a) To decrease or eliminate the amount of the Reserve for Loss Contingencies when determined necessary by the board of directors:

Dr.-Reserve for Loss Contingencies	\$2,000	
Cr.-Undivided Earnings		\$2,000

Detailed Transactions

Credit:

a) As authorized by the board of directors with amounts to be established as a Reserve for Loss Contingencies and with authorized increases in this reserve.

Debit:

a) As authorized by the Board of Directors with amounts to decrease the Reserve for Loss Contingencies.

Reserve for Nonconforming Investments

Federally-insured state chartered credit unions are required under terms of the insurance agreement to establish an investment valuation reserve for non-conforming investments which are otherwise accounted for at historical cost (e.g., non-conforming held-to-maturity securities). Nonconforming investments are those investments permissible under state law for a state chartered credit union, but which are impermissible for federally chartered credit unions. Refer to Part 741.3(a)(3) of the NCUA Rules and Regulations for further explanation. Refer to "Reserve for Loss Contingencies" above for similar illustrative accounting entries and detailed transactions.

ACCUMULATED UNREALIZED GAINS/ LOSSES ON AVAILABLE-FOR-SALE SECURITIES

This account, an item of Other Comprehensive Income, is used to record unrealized gains/losses on available-for-sale (AFS) securities. When available-for-sale securities are written to fair value, an entry is made directly to the investment account with the corresponding debit/credit to this account. This account is a separate component of equity; separate from the regular reserve or undivided earnings. Nonetheless, this separate equity account should be netted against accumulated current and undivided earnings *when assessing a credit union's ability to pay dividends*.

Upon disposition of the related security, the portion of this account that relates to the security disposed of is reversed with the gain or loss on disposition of the security recorded through the income statement as a Gain or Loss on Disposition of Investments. Refer to "Investments" in Section 300 of this manual for further explanation and illustrative entries.

DONATED EQUITY

This account is used by credit unions under \$10 million in assets that wish to account for the receipt of donated fixed assets under a regulatory accounting practice (RAP). Generally accepted accounting principles (GAAP) require such donations to be recorded as income when received. Credit unions following GAAP should record all contributions received/made in income/expense when received/made. Contributions include many of the donations credit unions receive such as office space, utilities, auditing service, etc.

Under this RAP, when a credit union receives as a gift or donation a tangible fixed asset of material value, the value of such asset should be established by a credit to this account as a separate classification of the credit union's equity. The offsetting debit should be to the appropriate asset account(s) for tangible fixed assets: e.g., furniture and equipment, building, etc.

Donated fixed assets should be recorded in the accounts based on the estimated fair market value of the assets at the date of acquisition. Depreciation of donated fixed assets should be charged to

expense in each accounting period over the useful lives of the assets in the same manner as for other fixed assets.

When fixed assets donated to a credit union are not considered of a "material" value, the value of the assets debited to the appropriate fixed asset account(s) should be credited to "Other Non-operating Income (Expense)".

Note: Contributions of cash or reimbursement of services or other expenses (e.g., office space, utilities, supplies, etc.) that are not tangible fixed assets, should be credited to "Other Non-Operating Income" with the offsetting debit to cash or the appropriate expense account. Refer to "Other Non-Operating Income" in Section 600 of this manual for further explanation.

Entries are illustrated below.

Illustrative Entries

- a) When a donated fixed asset of material value is received by the credit union:

Dr.-Furniture and Equipment	\$2,400	
Cr.-Donated Equity		\$2,400

- b) When the sponsor contributes for payment of utilities on the credit unions behalf:

Dr.-Utilities Expense	\$500	
Cr.-Other Miscellaneous		
Operating Income		\$500

- c) When depreciation is recorded:

Dr.-Depreciation of Furniture & Equipment	\$120	
Cr.-Allowance for Depreciation of Furniture and Equipment		\$120

Dr.-Donated Equity	\$120	
Cr.-Miscellaneous Income		\$120

d) If donated equipment is disposed of by sale: assume a donated asset valued at \$2,400 with an accumulated allowance for depreciation of \$900 is sold for cash of \$1,600. The entry is:

Dr.-Donated Equity	1,500	
Dr.-Cash	\$1,600	
Dr.-Allowance for Deprecia- tion of Furniture and Equipment	900	
Cr.-Furniture and Equipment		\$2,400
Cr.-Gain (Loss) on disposition of Assets		100
Cr.-Miscellaneous Income		1,500

NET INCOME (LOSS)

This account is used to accumulate the various income and expense accounts into a single account to determine the net income or loss for the accounting period and to transfer the net income or loss to "Undivided Earnings".

This account is credited with:

a) The credit balances of all operating income, operating expense, and non-operating income (expense) accounts when the books are closed; offsetting debits should be to the individual General Ledger income and expense accounts showing credit balances.

This account is debited with:

a) The debit balances of all operating expense, income and non-operating income (expense) accounts when the books are closed; offsetting credits should be to the individual General Ledger

income and expense accounts showing a debit balance.

b) The balance of this account, if a credit, after all income and expense accounts are closed; offsetting credit should be to "Undivided Earnings".

Entries in the Journal and Cash Record

All entries affecting this account should be entered as "Miscellaneous" in the Journal and Cash Record.

Posting to the General Ledger

Entries to this account are posted individually from the "Miscellaneous" grouping in the Journal and Cash Record to the General Ledger. The "Explanatory Remarks" related to this account in the General Ledger should be used to indicate the nature of amounts closed into or transferred from this account.

Illustrative Entries

a) To close the income and non-operating gain accounts with credit balances:

Dr.-Interest on Loans	\$6,000	
Dr.-Income from Other Investments	2,000	
Dr.-Fees and Charges	65	
Dr.-Gain (Loss) on Invest- ments	100	
Cr.-Net Income (Loss)		\$8,165

b) To close the operating expenses and income accounts with debit balances:

Dr.-Net Income (Loss)	\$6,920	
Cr.-Interest Refunds		\$1,800
Cr.-Rent		1,200
Cr.-Communications		120
Cr.-Provision for Loan Losses		600
Cr.-NCUA Operating Fee		200
Cr.-Dividends		3,000

c) To transfer net income for the period to Undivided Earnings:

Dr.-Net Income (Loss)	\$1,245	
Cr.-Undivided Earnings		\$1,245

Detailed Transactions

Credit:

a) When books are closed with the sum of the credit balances of all operating and non-operating income (expense) and operating expense accounts.

b) With balance of the account, if a debit, after all income and expense accounts have been closed; transfer to Undivided Earnings.

Debit:

a) When books are closed with the sum of the debit balances of all operating and non-operating expense and income accounts.

b) With balance of the account, if a credit, after all income and expense accounts have been closed; transfer to Undivided Earnings.

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INTEREST INCOME**LOANS RECEIVABLE****Interest on Loans***MODIFIED CASH BASIS OF ACCOUNTING*

For credit unions following the modified cash basis of accounting, this account should reflect the interest received on loans to members, i.e., only that interest which is actually collected. This account should be credited as "Interest Received" in the Journal and Cash Record with the

interest collected on loans as shown in the daily summary cash received vouchers.

The credit union may wish to establish separate interest income accounts for the different loan account types to facilitate the computation of yields on the various types of loans.

Posting to the General Ledger

The total of the respective "Interest Received" accounts in the Journal and Cash Record should be posted to the General Ledger at the close of each month.

Illustrative Entries

- a) When an installment on a loan is repaid and interest and late charges are collected:

Dr.- Cash	\$11.10	
Cr.- Loans		\$10.00
Cr.- Interest on Loans		1.00
Cr.- Other Fees & Charges		0.10

- b) When a member authorizes the credit union to transfer shares to loans and interest:

Dr.- Shares	\$25.25	
Cr.- Loans		\$24.00
Cr.- Interest on Loans		1.25

Detailed Transactions Modified Cash BasisCredit:

- a) At the end of each month with interest collected on loans outstanding.

Debit:

- a) With the balance of the account when the income accounts are closed and transferred to the Net Income (Loss).

ACCRUAL BASIS OF ACCOUNTING

For a credit union following the accrual basis, this account should include the amount of interest earned and uncollected on the various types of loans. Interest should not be accrued on any loans which are 3-months or more delinquent. At the end of each month, the credit union should credit this account with the total uncollected interest earned during the month, with offsetting charges to *Accrued Interest on Loans*. Refer to "Accrued Interest on Loans" in Assets – Section 300 of this manual for further guidance and illustrative entries.

This account should also include periodic yield adjustments to net loan origination and commit-

ment fee accounts. Refer to *Net Origination Fees and Costs* for further explanation and illustrative entries.

Detailed Transactions Accrual BasisCredit:

- a) At the end of each month with the uncollected interest earned on loans outstanding.

- b) With adjustments, subject to the approval of the board of directors, when interest collections exceed the balance of the accrued interest account(s).

- c) At the end of each month with periodic yield adjustments from loan origination and/or commitment fee accounts.

Debit:

- a) With adjustments required to charge off accrued interest when loans are charged off with the approval of the board of directors.

- b) With adjustments, subject to the approval of the board of directors, when interest collections are less than accruals or balance of that account.

- c) On the first day of each month with an adjustment to reverse the accrual set up at the end of the previous month, or actual interest payments received.

- d) With the balance of the account when the income accounts are closed and transferred to the Net Income (Loss).

Interest Refunds

This account reflects the amount of interest refunds for the accounting period based upon action by the board of directors or entries made on a monthly basis to estimate an interest refund which will be made in a dividend period. The entry recording the interest refunds is made as of the last day of the dividend period. When the board of directors defers action to declare interest refunds until the first month following the dividend period, this entry should be made retroactively as of

the close of the affected dividend period. The offsetting entry for interest refunds declared and recorded in this account is made to *Interest Refunds Payable*. Refer to *Interest Refunds Payable* in the Liabilities Section of this Manual.

At the option of the board of directors, the estimated interest refunds anticipated to be paid for any dividend period may be recorded by entries to spread the cost over the dividend period. Under this optional procedure the appropriate portion of the next anticipated interest refund will be recorded each month by charging this account and crediting *Other Accrued Expenses*; e.g., for a 6-month period, one-sixth of the anticipated amount of the next interest refund would be recorded each month, or if a 10 percent refund is planned for the dividend period, an entry for 10 percent of interest on loans for the month could be recorded as a debit to *Interest Refunds* and credit to *Other Accrued Expenses*. When the actual amount of the interest refund is determined at the end of the accounting period, the estimated amounts must be adjusted by an appropriate debit or credit to this account for the difference between the estimate and the actual amount. The adjustment and the actual amount of the refund as of the end of the accounting period would be recorded as described below.

Entries in this Journal and Cash Record

The amount declared for payment by the board of directors is recorded by entry in the Miscellaneous Credit column of the Journal and Cash Record by a debit to this account, with an offsetting credit to *Interest Refunds Payable*. When the board of directors defers action to declare the interest refund payable until the first month following the dividend period affected, this entry is made retroactively as of the close of the affected dividend period.

Posting to the General Ledger

The charge to this account as Miscellaneous in the Journal and Cash Record should be recorded as of the close of the accounting period to which applicable.

Illustrative Entries

- a) When a refund of interest to borrowers is authorized by the board:

Dr.- Interest Refunds	\$2,000	
Cr.- Interest Refunds Payable		\$2,000

- b) When the interest refund is paid in cash or credited to share accounts:

Dr.- Interest Refunds Payable	\$2000	
Cr. Cash		\$2000

OR

Cr.- Shares		\$2000
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- c) To record a monthly estimated interest refund, where the board estimates that a 5% interest refund will be paid at the end of some future dividend period, and gross interest on loans for the month is \$5,000:

Dr.- Interest Refunds	\$250	
Cr. Other Accrued Expenses		\$250

An entry based on the above sample computation would be made each month. The credit union may have certain categories of loans where the board has determined that an interest refund will not be given (such as delinquent loans, or on certain interest-rate categories). In this case, adjusted estimates of the above entry would be made.

Detailed Transactions

Debit:

a) With total interest refunds authorized by the board of directors (contra entry to *Interest Refunds Payable*).

Credit:

a) With the balance of the account to close it to *Net Income (Loss)* at the end of the accounting period.

Note: The above debit entry may be recorded based on an estimate (see illustrative entry c.). This requires an adjustment based on actual interest refunds distributed by an appropriate debit or credit to this account in the next accounting period for the difference between the estimate and actual amounts, with an offsetting entry to *Other Accrued Expenses*.

INVESTMENTS

MODIFIED CASH BASIS OF ACCOUNTING

For credit unions following the modified cash basis of accounting, these accounts should reflect the amount of interest income received (actually collected) from investments in the credit union's portfolio. Interest income account should be separated according to investment account types as described in the Investment section of this manual. Separation of income to compare with investment balances facilitates yield computations on the various types of investments.

Detailed Transactions Modified Cash Basis

Credit:

a) With interest earned on the respective investment asset as the transactions occur.

b) With the accretion of discount applicable to the period covered by each interest collection on the related securities. Contra debit should be to applicable securities asset account.

Debit:

a) With the amortization of premium applicable to the period covered by each collection of interest on the related securities. Contra credit should be to the securities asset account.

b) With the balance of the account to close it to *Net Income (Loss)* at the end of the accounting period.

ACCRUAL BASIS OF ACCOUNTING

The income account should be credited with the amount of income earned on the asset but not yet collected.

Illustrative Entries

To accrue one month's interest on \$12,000 of 5% U.S. Government Obligations; semi-annual interest of \$300.00 divided by 6 to compute amount applicable to each month:

Dr.- Accrued Income from	\$50.00
Investments	
Cr.- Income from U.S. Gov-	
ernment Obligations	\$50.00

Interest on Trading Securities

This account is used to record interest earned from trading securities. The income is generally received in the form of cash and should be recorded separately from trading profits and losses that result from adjustments to the fair value of the trading securities. Refer to "Investments" in Assets – Section 300 of this manual for illustrative entries and further guidance in accounting for trading securities.

Interest on Securities Available for Sale

This account is used to record the interest earned on securities classified as available for sale. Interest income, including amortization of any premium and/or discount should be included in the income statement. Refer to "Investments" in Assets – Section 300 of this manual for illustrative entries and further guidance in accounting for trading securities.

tive entries and further guidance in accounting for securities available for sale.

Interest on Securities Held to Maturity

This account is used to record the interest earned on investments classified as held-to-maturity. Interest income, including amortization of any premium and/or discount should be included in the income statement. Refer to "Investments" in Assets – Section 300 of this manual for illustrative entries and further guidance in accounting for securities classified as held-to-maturity.

OTHER INTEREST INCOME

Interest on Cash and Cash Equivalents

This account is used to record the interest earned on cash and cash equivalents. Cash and cash equivalents are short-term, highly liquid investments with maturities of 3 months or less. Examples include overnight accounts at a bank or corporate credit union, Fed Funds sold, and checking accounts.

Interest on Deposits in Commercial Banks, S&Ls, Savings Banks

This account is used to record dividends and interest earned/received from deposits in Commercial Banks, S&Ls and Savings Banks.

Illustrative Entries

Dr. -Deposits in Commercial Banks, S&Ls & Savings Banks	\$100.00
Cr. Income from Commercial Banks, S&Ls, & Savings Banks	\$100.00

Detailed Transactions

Credit:

With dividends and interest credited to the credit union's investment in commercial banks, S&Ls, and savings banks.

Interest on Deposits & Certificates of Corporate Credit Unions

This account is used to record dividends and interest earned/received from deposits and certificates of corporate credit unions.

Illustrative Entries

Dr. - Corporate Credit Union	\$50.00
Cr. Income from Corporate Credit Unions	\$50.00

Detailed Transactions

Credit:

With dividends and interest credited to the credit union's investment in corporate credit unions.

Income from CUSO

This account is used to record income earned or received on a loan or investment in a credit union service corporation accounted for under either the Equity Method or the Cost Method of accounting. The recorded income is based on the transactions recorded in *Investments in Credit Union Service Corporation*. The Equity Method of accounting will result in a change in the investment balance of the Asset Account (asset balance increases or decreases depending on whether the service corporation's operations result in a net income or net loss, respectively, during an accounting period). May need to consult an independent accountant for an understanding of Equity Accounting or Consolidation.

Income from Other Investments

This account is used to record income from investments that are not identified in any other investment account.

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NON-INTEREST INCOME

GAINS (LOSSES) ON INTEREST EARNING ASSETS

Gains (Losses) on Investments

This non-operating income (expense) classification reflects primarily the gain or loss during the accounting period on the sale of AFS securities. (Note: Gains or Losses on the disposition of Trad-

ing account investments are recorded in "Trading Profits and Losses".)

Upon sale or other disposition of all AFS securities, the difference between amortized cost of the securities disposed of and the proceeds received by the credit union should be credited to this account if a gain, or charged to this account if a loss. The portion of this gain (loss) included in *Other Comprehensive Income (Accumulated Unrealized Gains/Losses on AFS Securities)* must be reversed.

The AFS security account is credited to reflect the removal of the security from the books.

This account also includes estimated losses resulting from other-than-temporary material declines (impairment) in fair values of AFS or HTM securities. When recognition of such losses is imminent, a schedule of investments needs to be furnished to the board of directors listing each investment as to the:

- (a) Identification of the investment,
- (b) The credit union's dollar carrying value,
- (c) The estimated current market value, and
- (d) The estimated loss that will be sustained.

The amount of the loss to be recorded needs to be approved by the board and is incorporated into the minutes based on the above schedule. It should be recorded by debiting "*Gains (Losses) on Investments*," and crediting the respective security account. Impairment losses should be rare. Most declines in the value of securities are temporary.

Entries in the Journal and Cash Record

All entries to this account should be made as a "Miscellaneous Debit" or "Miscellaneous Credit" in the Journal and Cash Record based upon Cash Received Vouchers or Journal Vouchers prepared for each individual transaction.

Illustrative Entries

- a) To record a net gain on the sale of AFS securities for the excess of proceeds received over the credit union's carrying value:

Dr.- Cash	\$1,000	
Dr.- Unrealized		
Gain/Loss on AFS	20	
Cr.- AFS Securities		\$980
Cr.- Gain (Loss) on Investments	40	

- b) To record an estimated potential loss of a other-than-temporary nature on AFS securities due to a decline in the expected realizable value as authorized by the board of directors:

Dr.- Gain (Loss) on Investments	\$2,000	
Cr.- AFS Securities		\$2,000

Detailed Transactions

Credit:

- a) With amounts of gains on sales or other dispositions of AFS securities, representing the excess of proceeds received over net carrying value.
- b) With balance of account, if a debit, when books are closed (transfer to the Net Income (Loss) account).

Debit:

- a) With net losses on sales or other disposition of AFS securities, representing the excess of credit union's carrying value of the investments disposed of over the proceeds received.
- b) With balance of account, if a credit, when books are closed (transfer to the *Net Income (Loss)* account).
- c) With the amount of an other-than-temporary decrease in the value of AFS or HTM securities.

TRADING SECURITIES PROFIT (LOSSES)

This account is used to record periodic changes in the fair value of trading securities and gains and losses resulting from the disposition of trading investments. Trading account securities should be marked to fair value monthly.

Illustrative Entries

- a) To record the write-down of trading securities to fair value. Assume that trading securities are presently carried at \$15,000 and current fair value is \$14,000:

Dr.- Trading Profits and

Losses	\$1,000	
Cr.- Trading Securities		\$1,000

b) To record the increase in the fair value of trading securities. Assume the current fair value of the securities has risen to \$17,000:

Dr.- Trading Securities	\$3,000	
Cr.- Trading Profits and Losses		\$3,000

Detailed Transactions

Debit:

a) With a decrease in fair value of trading securities.

Credit:

a) With an increase in fair value of trading securities.

MEMBER SERVICE FEES

Loan Origination Fees

Income resulting from nominal, nonrefundable loan origination fees on loans to members, i.e., commercial, agricultural and consumer loans, should be credited to this account in full, as collected when the following criteria are met:

- The fees are nominal.
- The direct costs incurred are nominal.
- The maturity of the lending transaction is short term in nature.

For term loans, the net origination fee (costs) if material, should be deferred and amortized over the life of the loan by the interest method as an adjustment to yield. Refer to "Loans" – Section 300 of this manual for further explanation and illustrative entries.

Other Fees and Charges

Other fees and charges include income collected from membership fees and late charges on credit union loans to members.

Miscellaneous Fee Income

These accounts are used to record operating income of the credit union for which no specific account is provided. Such items include un-presented check fees and reimbursement fees (for costs of selling checks, cashing checks, and handling insurance), etc.

Unpresented Checks

When the statutory period prescribed for the presentation of checks has expired, such items may be credited to this account with an offsetting debit to "Accounts Payable". See discussion of unpresented checks under *Accounts Payable*. Before the accounts of any unpresented checks are credited to this account, it needs to be determined whether an abandoned property law is in force in the state.

Interest on Insurance Premiums Receivable

Interest collected on reimbursable insurance premiums which have been advanced on behalf of member-borrowers is credited to this account.

Reimbursement Fees

Fees collected from members are credited to this account.

Entries in the Journal and Cash Record

This account is credited as a "Miscellaneous Credit" with fees collected for the sale of checks or money orders, for the cashing of checks, for the sale of insurance to members and any other miscellaneous operating income. If credits to this account are numerous, you might choose to record the credits to the special Cash account.

Illustrative Entries

a) When a credit union receives payment for the printing of share drafts and charges a fee for this service:

Dr.- Cash	\$21.00	
Cr.- Accounts Payable		\$20.00
Cr. - Misc. Fee Income		1.00

Note: The actual cost of printing the share drafts is set up as an accounts payable as shown and is remitted to the printer upon receipt of the finished order.

b) When a check is cashed for a member for a fee or a reimbursement fee is collected for the purchase of insurance:

Dr.- Cash	\$5.00	
Cr. - Misc. Fee Income		\$5.00

c) When income is received for which no other income account is provided:

Dr.- Cash	\$2.00	
Cr. - Other Misc. Operating Income		\$2.00

LOAN SERVICING FEES

This account is used to record fees earned in conjunction with servicing loans, credit cards or other financial assets. Further discussion of this topic is outside the scope of this manual. Credit unions involved in servicing loans or other assets should seek the guidance of an independent accountant.

INSURANCE COMMISSIONS

This account is used to record income earned on insurance commissions. Section 721.2 of the NCUA's Rules & Regulations sets forth the reimbursement and compensation limitations a FCU may receive from third party vendors of insurance. The NCUA does not limit the compensation a FCU may receive in connection with the sale of insurance that is directly related to an extension of credit. FCUs are subject to state laws applicable to the sale of insurance, including any limits the state may place on insurance commissions.

OTHER

Income from NCUSIF Investment Refund

This account is used to record redistributions (dividends) of NCUSIF equity to insured credit unions when the NCUA Board makes an annual, proportionate adjustment of the amount necessary to reduce the NCUSIF to its normal operating level.

Illustrative Entries

Dr.- Cash or Accrued	
Income on NCUSIF	\$450.00
Cr.- Income from Investment	
in NCUSIF	\$450.00

Note: Accruals should be recorded only after the NCUA Board declares a redistribution from the NCUSIF, not in anticipation of a declaration of dividends.

Detailed Transactions

Credit:

a) With redistributions of NCUSIF equity that have been declared by the NCUA Board of Directors.

Gain (Loss) On Disposition/Impairment Of Assets

This non-interest income (loss) account is used to record a gain or loss realized during the accounting period as a result of:

- the sale or other disposition of credit union owned fixed assets (e.g., land, building, furniture, equipment)
- a significant decrease in the market value (impairment) of credit union owned long-lived assets (e.g., building)
- writing down assets acquired in liquidation of loans to the lower of (a) fair value minus

estimated costs to sell or (b) cost at the time of foreclosure

Refer to "Assets Acquired in Liquidation of Loans" and "Property and Equipment" in Assets - Section 300 of this manual for further explanation and illustrative entries.

OTHER NONOPERATING INCOME (EXPENSES)

This non-operating income (expense) account reflects all non-operating income received or expenses or losses incurred for which no specific account is provided. This account should include such items as the value of donations and gifts received except in the case of a donated fixed asset of material value which may be recorded as Donated Equity.

Entries in the Journal and Cash Record

Entries to this account should be made as a "Miscellaneous Credit" or "Miscellaneous Debit" in the Journal and Cash Record based on Cash Received Vouchers or Journal Vouchers prepared for each individual transaction.

Detailed Transactions

Credit:

- a) With the amount of gifts and donations received except tangible fixed assets of substantial value for which the credit entry should be to "*Donated Equity*."
- b) With the amount of miscellaneous non-operating income received by the credit union for which no other account is specifically prescribed.
- c) With amounts equivalent to depreciation charged to expense during the period on donated tangible fixed assets; offsetting debit should be to "*Donated Equity*."
- d) With balance of account, if a debit, when books are closed (transfer to the *Net Income (Loss)* account).

Debit:

- a) With the amount of any miscellaneous non-operating expenses of the credit union not specifically chargeable to other accounts.
- b) With balance of account, if a credit, when books are closed (transfer to the *Net Income (Loss)* account).

EXTRAORDINARY GAINS AND LOSSES

This account is used to record gains and losses resulting from events or transactions that are of an unusual nature and are infrequent in occurrence. Both of the following criteria must be met to classify an event or transaction as an extraordinary item:

- a) *Unusual nature* - the event or transaction possesses a high degree of abnormality and is of a type clearly unrelated to, or only incidentally related to the ordinary and typical activities of the credit union, taking into account the environment in which the credit union operates.
- b) *Infrequency of occurrence* - the event or transaction is a type that would not reasonably be expected to recur in the foreseeable future.

Examples of extraordinary losses might be a loss resulting from a major casualty such as a flood, earthquake, or hailstorm in a locality where the event would be extremely rare.

Entries in Journal and Cash Record

All entries to this account should be made to the "Miscellaneous Debit" or "Miscellaneous Credit" columns of the Journal and Cash Record based upon Cash Received or Journal Vouchers prepared for each individual transaction.

Illustrative Entries

-
- a) To record the net loss sustained from a flood that destroyed the credit union's office furniture and equipment (inclusive of computers) that occurred in a locale where a flood has never been experienced.

Dr.- Extraordinary Gains and Losses	\$40,000
Dr.- Allowance for De- preciation of Furni- ture and Equipment	500
Cr.- Furniture and Equip- ment	\$40,500

Detailed TransactionsCredit:

- a) With extraordinary gains resulting from an unusual event or transaction of an infrequent nature.

Debit:

- a) With extraordinary losses resulting from an unusual event or transaction of an infrequent nature.

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GENERAL RULES FOR RECORDING EXPENSES

OPERATING EXPENSES (GL Control Account)

All operating expenses of the credit union are to be recorded in the General Ledger. The individual expense charges identified to each separate operating expense classification in the Journal and Cash Record should be posted individually or in summary total for the month to the related expense accounts in the General Ledger. At the option of the credit union, an Operating Expenses (Control) account and an Expense Ledger may be used to summarize the detailed expense charges. The expense accounts in this series should be closed into "Net Income (Loss)".

Approval Of Expenses

The board of directors of each credit union is responsible for insuring that all expenses are reasonable in amount and necessary to the operation of the credit union. Expenses incurred must be submitted to the board of directors for approval. For many routine recurring expenses, the approval may take place during the review of expenses at each monthly board meeting, which would constitute an after-the-fact approval of the expense items. On the other hand, larger or non-routine expenditures should be specially authorized by the board before the obligation is incurred, unless the expenditure is contained in a budget which has previously been approved by the board.

Disbursements for expenses should be supported by invoices, receipts or vouchers giving a complete description and the details of the items involved. Reimbursements of officers, directors, committee members and employees for expenses incurred by them in connection with the conduct of credit union business or attendance at credit union affairs are permissible. Reimbursement can only be made when actual expenses of a reasonable amount are supported by an itemized expense account with supporting receipts and vouchers. A fixed or standard rate type reimbursement cannot be made to directors or officers for time spent in connection with attendance at credit union meetings or affairs.

In cases where credit union personnel receive expense funds in advance, an accounting should be made to the credit union promptly after the event for which the funds were advanced. If the funds advanced exceed the actual itemized expenses of a reasonable amount incurred by the individual, the unused balance of the advance should be returned to the credit union. On the other hand, if the actual itemized expenses of a reasonable amount incurred exceed the amount of the advance, the individual should be reimbursed for the additional amount covered by his accounting.

Substantial expenses applicable to the current accounting period which will not be paid promptly should be charged to the appropriate expense account and credited to *Accounts Payable* at the time the expense is incurred.

Income should not be netted against expenses for individual items such as share drafts, data processing, arbitrage activities, etc. Such a netting procedure is not consistent with GAAP and distorts income and expense. Rather, all income, expenses, gains and losses affecting each accounting or dividend period should be recorded through income and expense accounts.

Entries in the Journal and Cash Record

Each account in this series should be debited as an "Operating Expenses (Control)" in the Journal and Cash Record when an expense is paid or incurred. Such accounts should be credited with the amount of adjustments and refunds made. The specific account classification of each item should be shown in within "Accounts."

Debits to the "Operating Expenses (Control)", should be recorded as normal entries, but credits should be entered in red or in parentheses. When totaling the column at the month end, the items in red or in parentheses should be deducted from other items to reach a net total of charges for the month.

Posting to the General Ledger

The total of the operating expense charges and credits recorded in the Journal and Cash Record should be posted to the appropriate accounts in the General Ledger at the end of each month.

Illustrative Entries

a) When a check is issued in payment of any classification of operating expenses, e.g., payment for rental of office quarters:

Dr.- Rent	\$125.00	
Cr.- Cash		\$125.00

b) Whenever a cash refund is received representing an overpayment of an operating expense; e.g. overpayment of utility expenses:

Dr.- Cash	\$16.25	
Cr.- Utilities		\$16.25

c) To record depreciation of furniture and equipment:

Dr.- Depreciation of Furniture and Equipment	\$65.00	
Cr.- Allowance for Depreciation of Furniture and Equipment		\$65.00

d) To record amount of adjustment to increase the Allowance for Loan Losses account:

Dr.- Provision for Loan Losses	\$175.00	
Cr.- Allowance for Loan Losses		\$175.00

e) When any part or the entire amount of the "Unamortized Organization Costs" is written off:

Dr.- Miscellaneous Operating Expenses	\$12.50	
Cr.- Unamortized Organization Cost		\$12.50

f) When an expense is incurred for promotional or advertising material and the check in payment is not immediately forwarded:

Dr.- Publicity and Promotions	\$108.50	
Cr.- Accounts Payable		\$108.50

MODIFIED CASH BASIS OF ACCOUNTING

Detailed Transactions

Debit:

a) With charges to each expense classification as recorded in the Journal and Cash Record at the close of each month. These charges should include transactions disbursed in cash as well as expense transactions not involving cash disbursements, such as entries to depreciate fixed assets, establish or increase the allowance for loan losses, etc.

Credit:

- a) With credit entries to each expense classification as recorded in the Journal and Cash Record at the close of each month.
- b) With balance of account when books are closed (transfer to the *Net Income (Loss)* account).

ACCRUAL BASIS OF ACCOUNTING

Credit unions following the accrual basis of accounting should record significant amounts of operating expenses in such a manner as to allocate the expenses to the period to which applicable regardless of when due and payable. This should be accomplished by recording expenses as accounts payable or accrued expenses if the amounts have not been paid, or as prepaid or deferred charges if paid but applicable to future periods.

*Detailed Transactions*Debit:

- a) With charges to each expense classification as recorded in the Journal and Cash Record at the close of each month. These charges should include transactions disbursed in cash as well as those expense transactions not involving cash, such as entries to record accruals of unpaid bills, to depreciate fixed assets, to establish or increase the allowance for loan losses, to write off to cost appropriate amounts previously recorded as prepaid or deferred expenses, etc.

Credit:

- a) With credits to each expense classification as recorded in the Journal and Cash Record at the close of each month. These entries will include both cash refunds of operating expenses and other

transactions, such as adjustments of accruals, decreases in the allowance for loan losses, etc.

- b) With balance of account when books are closed (transfer to the Net Income (Loss) account).

Expense Ledger

A subsidiary record of expenses is useful to analyze the expenses and to prepare the expense section of the Statement of Income. The optional Expense Ledger can be used for this purpose.

When posting to the Expense Ledger all debits and credits are entered as "Expense Total" and the proper amounts are extended in the distribution to the right. The credit postings are entered in red or in parentheses and subtracted from the total of the other items involved. The grand total of the distribution must be the same as the total of the "Expense Total" of the Expense Ledger and this total must agree with the balance of the "Operating Expenses Control."

Expense Classification - The Expense Ledger provides separate itemization for the primary classifications of the expenses occurring in the operations of the credit unions. Expense categories for which subordinate expense classifications are recommended also provide a designator for use in identifying the particular sub-classification of expense relating to each entry. The sub-classification account numbers should be inserted in the space provided to enable the credit union to analyze its expenses within each primary classification. The totals should be used for preparing the Statement of Income. This Statement provides only for reporting the primary classifications.

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INTEREST EXPENSE

MEMBERS' SHARES AND SAVINGS ACCOUNTS

Dividend Expenses

Regular Share Dividend Expense
Share Draft Dividend Expense
Club Account Dividend Expense
Ira/Keogh Dividend Expense
Ira/Keogh Certificate Dividend Expense
Share Certificate Dividend Expense
Money Market Dividend Expense
Other Dividend Expense

The above account classifications include the amount of dividends for each type of share account chargeable to the current accounting period based upon action by the board of directors, estimates, or per contractual agreements. The entries recording the dividend expense should be made no later than the last day of each dividend period regardless of whether the dividends were actually authorized by the directors on that date, or before or after that

date. Offsetting entries for charges to these accounts should be made to the appropriate accrued dividends payable account, dividends payable account or, if dividends are credited to members' accounts on the last day of the dividend period, to the appropriate General Ledger Share Account. When the board of directors defers action to declare dividends until the first month following the dividend period, entries should be made retroactively as of the close of the affected dividend period.

At the option of the board of directors, the estimated dividends anticipated to be paid for any dividend period may be recorded by monthly entries to spread the cost over the months comprising the dividend period. Under this optional procedure, the dividends should be allocated to the month that the expense was incurred, regardless of whether the dividends were declared or not. Accordingly, estimated dividends should be charged to their appropriate dividend expense accounts monthly. When this procedure is used, the offsetting credit is to the appropriate accrued dividends payable account. When the actual dividends are paid in cash or credited to shares, the balances in the appropriate divi-

dends payable or accrued dividends payable account should be cleared.

Credit unions which accrue dividend expenses on a more frequent basis than the actual dividend period should record the liability in "Accrued Dividends Payable". For example, a credit union which declares and pays quarterly dividends but accrues dividend expense monthly would record the liability in account "Accrued Dividends Payable" in between actual dividend periods. Refer to "Dividends Payable" and "Accrued Dividends Payable" in Liabilities – Section 400 of this manual for further guidance and illustrative entries.

Interest on Deposits

This account normally is not applicable to federal credit unions. However, its use may be appropriate for allocating the cost of interest-bearing deposits (deposits that are not considered shares) to the current accounting period.

BORROWED FUNDS

Interest On Borrowed Money

This classification includes the interest cost to the credit union for borrowed money. This includes interest paid on promissory notes, notes payable, mortgage notes payable, reverse repurchase agreements, Fed Funds and obligations under capital leases. For low-income designated credit unions, this account would also include interest associated with secondary capital accounts. Refer to "Borrowed Funds", "Accrued Interest Payable on Borrowed Funds" and "Subordinated CDCU Debt" in Liabilities – Section 400 of this manual for further guidance.

Illustrative Entries

-
- a) To record interest paid in conjunction with a mortgage note payable.

Dr.- Mortgage Notes Payable	\$400.00	
Dr.- Interest on Borrowed Money	10.96	
Cr.- Cash		\$410.96

Detailed Transactions

Debit:

- a) With periodic interest payments related to borrowed funds.

Imputed Interest Costs

Imputed interest costs are those which are derived from a computation of interest costs using an implicit interest rate. Interest costs result from the application of an approximated market interest rate to a note or other obligation of the credit union. The rate is used to discount the liability of the credit union to its present value. The Effective Interest Rate Method of computing interest (simple interest applied to the unpaid balance) is then used to determine the amount of periodic interest costs that should be recorded in this account. This approximates the cost of borrowing when the interest rate is not known, or when the rate is unrealistically low for the type of transaction.

Imputed interest costs often occur with transactions that include the exchange of long-term obligations for goods or services and a rate of interest has not been stipulated by the contracting parties or the stated rate is unreasonable relative to the current market conditions. The imputed rate is used in conjunction with determining the market value of the note and the cost of borrowing. Typical transactions include the purchase of long-term leases or loans, e.g., student loans.

Unexercised Commitment Fees

This account should be used to expense commitment fees paid to borrow funds where the commitment expires unexercised.

Commitment Fees On Borrowed Funds

This account should be used to expense commitment fees paid to borrow funds where the commitment fees are expensed based on the straight-line method of amortization.

PROVISION FOR LOAN LOSSES

This account is used to record the periodic charge(s) to operating expense necessary to maintain a reasonable allowance for loan losses. The amount of the current period provision should be adequate to establish or to increase the allowance to a sufficient level to cover estimated losses inherent in the loan portfolio. The use of sub accounts for the various types of loans is optional. However, their use provides valuable information when conducting loan analysis.

The accounts should be charged only with amounts required to establish or increase the balance of the "*Allowance for Loan Losses*" in order to provide for estimated probable losses existing on outstanding loans and other receivables. The accounts should be credited only with amounts to decrease the allowance to provide for such current estimated probable losses. All charge-offs of uncollectible loans and other receivables as well as non-recoverable costs chargeable to borrowers should be debited directly to the allowance when cleared from the asset account(s) with the prior approval of the board of directors. Regular and consistent funding of the *Allowance for Loan Losses* should be carried out at least quarterly, and in some cases monthly, to ensure uniform charges to the *Provision for Loan Losses* over the annual accounting period. Refer to "Allowance for Loan Losses" in Assets – Section 300 for further guidance and illustrative entries.

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NON-INTEREST EXPENSE

COMPENSATION AND BENEFITS

Compensation

Salaries

This classification is to include all compensation of the treasurer and the salaries of all credit union employees such as the manager, assistant treasurer, bookkeepers, tellers and other office employees. This account also includes amounts paid to employees as bonuses. This account should include that portion of compensation which represents social security taxes withheld from employees' pay.

Reimbursement To Sponsor For Payroll-Related Services

When credit union employees are on the sponsor company's payroll and the company bills the credit union a lump-sum for the salary, fringe benefits and other services it provides, reimbursement by the credit union should be recorded in this account. If the sponsor company's billing shows a breakdown so that the credit union can determine the amount of salary and miscellaneous benefits, the

reimbursement should be classified in the appropriate expense subsidiary categories.

Other Compensation

This account includes all other compensation expenses chargeable to the current accounting period that are not specifically accounted for in the previous accounts.

Employee Benefits

Pension Plan Costs

This classification includes all charges to expense relating to the credit union's pension plan. Although the plan termination insurance and the contingent liability insurance could be included in this category, it is recommended that these two insurance costs, along with fiduciary liability insurance, be included in an "Insurance" account. A full discussion of pension plan accounting is beyond the scope of this Manual – seek the assistance of an independent accountant who can inform you concerning accounting rules for pensions under generally accepted accounting principles.

Social Security Taxes (Employer's Share)

This classification includes only the employer's (credit union's) share of social security taxes which are paid on salaries. Social security taxes withheld from the employee's salaries should not be recorded in this account, but should be included in "Salaries". See "Social Security Taxes Payable".

Unemployment Compensation Taxes

This classification includes the employer's (credit union's) costs for Federal and state unemployment compensation taxes which are paid by the credit union on salaries.

Other Employee Benefits

This classification includes the costs to the credit union of other benefits provided to employees; e.g., group life insurance costs.

OCCUPANCY

Office Occupancy Expenses

Rent

This classification includes the cost of rent for space occupied.

Maintenance Of Building

This classification includes all costs incurred relating to the maintenance of a building owned or occupied by the credit union.

Utilities

This classification includes all utility costs related to space occupied by the credit union for heat, light, water, etc.

Depreciation Of Buildings

This classification includes the aggregate amount written off to expense in the current period for the depreciation of buildings owned by the credit union.

Amortization Of Leasehold Improvements

This classification includes the prorated portion of leasehold improvement costs that are charged to the current period. Leasehold improvement costs should be systematically amortized over the assets' useful lives or the period covered by the lease agreement, whichever period is less.

Real Estate Taxes

This expense account includes the costs of real estate taxes on buildings owned by the credit union.

Depreciation Expense For Leased Assets

This account includes the prorated portion of leased asset costs that are charged to the current period. The costs of leased assets should be systematically depreciated over the assets' useful lives or the period covered by the lease agreement, whichever period is less. Assets included in this category should be directly related to space and/or building occupancy.

Other Office Occupancy Expenses

This account should include all other office occupancy costs that are charged to the current period.

OTHER GENERAL AND ADMINISTRATIVE

Office Operations Expenses

Communications

This classification includes all charges for telephone, telegraph, and postage expense.

Rental Of Furniture And Equipment

This classification includes the cost of leased furniture and equipment. It does not, however, include the cost of leases that are, or should be, carried as Capital Leases.

Maintenance Of Furniture And Equipment

This classification includes costs incurred for maintenance of office machines and other equipment, including the cost of service contracts.

Stationery And Supplies

This classification includes the cost of stationery, paper, printed forms, binders, pencils, calendar pads, ink, and other supplies incidental to the operation of the credit union.

Insurance

This subsidiary classification includes all insurance premiums except share insurance, loan protection, life savings and chattel lien non-filing insurance. It will include such insurance as surety bond coverage, compensation, fire, windstorm, public liability, property damage, burglary, robbery, etc. See "Other Prepaid Insurance" concerning the handling of surety bond premiums paid in advance.

Depreciation Of Furniture And Equipment

This account includes the aggregate amount of furniture and equipment depreciation expense that is charged to the current accounting period. Corresponding credits are recorded in the "Allowance for Depreciation of Furniture and Equipment". For additional information, refer to "Furniture and Equipment".

Bank Service Charges

This classification includes charges made by the bank, usually against the credit union's bank account, for services in connection with handling the account. Normally, these charges are listed on the bank statement and should be recorded in the Journal and Cash Records promptly after receipt of the

bank statement. The corresponding credit is recorded in Cash Account.

Other Office Operations Expenses

This account should include all the other office operating costs that are charged to the current period, not specifically accounted in any of the previous accounts.

Travel And Conference Expenses***Employees' Travel And Conference Expenses***

This account includes authorized expenses incurred by credit union employees (other than officers and directors) for travel, attendance at conferences and other meetings.

Officers' And Directors' Travel And Conference Expenses

This classification includes authorized expenses incurred by officers (including the Treasurer) and directors for travel, attendance at conferences and other meetings. (Note: The expenses of officers and directors in connection with efforts to collect loans should not be included in this account but should be charged to "Collection Expenses").

Other Travel And Conference Expenses

This account includes all other travel and conference expenses chargeable to the current accounting period that are not specifically accounted for in the previous accounts.

Educational And Promotional Expenses***Advertising***

This classification includes expenses incurred for advertising, such as advertisements or notices in newspapers, periodicals, radio or television.

Publicity And Promotions

This classification includes the costs that are chargeable to the current accounting period for educating the members in the functions and purposes of credit unions. Additionally, this account

is used to allocate the cost of nominally priced promotional items to the current accounting period.

Note: The expenses of directors and committee members, including travel and meals away from home, in connection with meetings of the official staff of the credit union and similar expenses of such officials in attendance at chapter, league and other credit union affairs should not be included in this classification. These latter expenses should be included under Employees' Travel and Conference Expenses or Officers and Directors' Travel and Conference Expenses. Additionally, other educational and training costs should be recorded in "Other Educational and Promotional Expense."

Other Educational And Promotional Expenses

This account includes all other educational and promotional costs chargeable to the current accounting period that are not specifically accounted for in the previous accounts.

Loan Servicing Expenses

Collection Expenses

This classification includes the costs incidental to the collection of delinquent loans. Generally, this includes expenses of officials and employees incurred in connection with efforts to collect loans. Such costs are usually not recoverable from the borrower. Collection costs which have been advanced to an outside source may also be charged to this account. See Specialized Accounting - Collection of Loans by Outside Sources.

Recording Fees-Chatel Lien Insurance

This classification includes the cost of recording liens on personal or real property accepted as security for loans. It also includes the premiums on chattel lien non-filing insurance policies.

Credit Reports

This classification includes costs of credit reports obtained by the credit union.

Refunds-Real Estate Finance Charges

This classification includes refunds made to members on real estate loans where prepayment of the loans causes the maximum interest rate limitation to be exceeded because of points or service charges paid by the borrowers when the loans were made. Refer to Topics of Special Interest – Section 800 of this manual for further guidance and illustrative entries.

Credit Card Program Expenses

This account is used to record appropriate credit card program expenses. Refer to Topics of Special Interest – Section 800 of this manual for further guidance and illustrative entries. Such expenses will include the cost of the cards, separate billing statements, or service fees paid in connection with the program.

Service Fees On Loans Purchased

This account is used to record service fee expenses incurred as the result of purchasing loans that are being serviced by another person or financial institution. Refer to Topics of Special Interest – Section 800 of this manual for further guidance and illustrative entries.

Other Loan Servicing Expenses

This classification includes all other loan servicing costs that are chargeable to the current period but which are not specifically accounted for in the previous accounts. Refer to Topics of Special Interest – Section 800 of this manual for further guidance and illustrative entries.

Professional And Outside Services

Legal Fees

This classification includes the cost of legal services applicable to the general operations of the credit union. Attorney fees and court costs which are related to the credit union's efforts to collect loans may be charged to this account if not recovered from the individual borrowers, or these cost may be treated as losses on loans and charged to "Allowance for Loan Losses".

Audit Fees

This account should be charged with the costs incurred relating to an audit or audits of the credit union's records, usually the supervisory committee audit and/or the verification of the members' accounts, which are performed by an outside accounting firm or other professionals.

Accounting Services

This classification includes expenses incurred for the performance of accounting services for the credit union by an outside person or firm. Expenses incurred in connection with a jointly owned accounting service center should also be included in this account. Charges assessed by a service center for performing data processing services for the credit union represent another example of an expense to be classified in this account.

Management Consulting Fees

This classification includes costs incurred by the credit union for the services of management consultants.

Other Professional And Outside Services

This account should include other professional and outside service costs that are allocated to the current accounting period but which are not accounted for in the previous accounts.

Member's Insurance***Share Insurance***

This classification includes the cost of the annual National Credit Union Share Insurance Fund premium paid by the credit union in connection with the insurance of share accounts under Title II of the Federal Credit Union Act.

Note: The annual share insurance fund capitalization deposit should be reflected in the asset account "Investment in NCUA Share Insurance Capitalization."

Life Savings Insurance

This classification includes the cost of premiums paid by the credit union for life savings insurance on the members. (Dividends on life savings insurance are discussed under the next expense classification, "Borrowers' Insurance.")

Borrowers' Insurance

This classification includes the cost of premiums paid by the credit union for life insurance protection on the borrowing members. Dividends on life savings insurance and borrowers' protection insurance (credit union insurance) will be subject to special handling. Since such dividends are, in effect, a return of a portion of the premiums paid, they may be credited to the appropriate expense classification. The offsetting debit should be to "Other Assets" if the dividend is in the form of a credit memo, or to "Cash" if the dividend is received by check. The dividend amount charged should be cleared when the credit memo is used in lieu of cash for the payment of future premiums.

If a dividend or refund of premium applies to both borrowers' protection and life savings insurance without a breakdown being furnished by the insurance company, the amount may be according to prorated portions of the combined year-to-date costs. If, however, a credit union desires to do so, the dividends may be recorded as "Other Miscellaneous Operating Income" rather than a credit to the expense account(s).

Other Members' Insurance

This account includes the cost of all other member insurance that is paid by the credit union and chargeable to the current accounting period.

Federal Operating Fee Expense

This account includes the annual operating fee assessed by NCUA in accordance with Section 105 of the Federal Credit Union Act. The computation of the operating fee will be provided to federally chartered credit unions on NCUA Form 1305, Share Insurance/Operating Fee Invoice. The fee is billed in March and payable on or before April 15 of each insurance year. Credit unions using the accrual

basis of accounting may defer the annual fee as a prepaid expense if the fee is \$500 or more.

Illustrative Entries

- a) To record the annual payment of the fee to NCUA.

Dr.- Federal Operating	
Fee Expense	\$600.00

OR

Dr.- Other Prepaid Ex-	
penses and De-	
ferred Charges	\$600.00
Cr.- Cash	\$600.00

- b) To record the periodic expensing of the prepaid operating fee.

Dr.- Federal Operating	
Fee Expense	\$50.00
Cr.- Other Prepaid Expenses	
and Deferred Charges	\$50.00

Detailed Transactions

Debit:

- a) With the payment of the operating fee (cash or modified cash basis of accounting).
- b) With amortization of monthly expense (accrual basis of accounting).

Cash Over And Short

This classification includes the amount of cash which is either over or short in connection with each day's collections. At the end of each day's business, the Cash Received Vouchers, or its equivalent, are totaled and the result checked with the cash on hand. If the cash on hand is greater than the total of the vouchers and the error is not located before the transactions for the day are recorded, an additional Cash Received Voucher or its equivalent is prepared for the amount of the over-

age. The words "Cash Over" are shown on the voucher in the "Received From" space. This voucher is included with other Cash Received Vouchers when preparing the summary voucher of the day's cash receipts and entered as "Cash Over" on the first blank line of the summary voucher.

If the total of the voucher is greater than the cash on hand and the error is not located before the transactions for the day are recorded, a Cash Received Voucher is prepared for the amount of the shortage. The words "Cash Short" are shown on the voucher in the "Received From" space. The amount of the shortage should also be written in red or parentheses opposite the "Total" line. This voucher should be included with the Cash Received Voucher when preparing the summary voucher for the day's receipts. The words "Cash Short" should be entered on the first blank line of the summary voucher. The amount of the cash short should be entered in red or in parentheses on the summary voucher of the day's receipts in the amount column opposite "Cash Short". This amount should be a deduction from the other items. The net cash shown on the summary voucher should then agree with the cash on hand.

The amount of the cash short or over for each day should be recorded in the "Expense" column of the Journal and Cash Record. If the amounts represent overages, they should be entered in red or parentheses and should be deducted from the total of the other items.

When an error which has been recorded as a cash overage or a cash shortage is located, a Journal Voucher or its equivalent should be prepared to reverse the original debit or credit entry to this account. The correcting entry should be entered in the Journal and Cash Record from this Journal Voucher. For instance, if it is later discovered that a cash overage resulted from failure to prepare a Cash Received Voucher in connection with a payment received on shares, the Cash Over and Short account should be debited and the Shares account should be credited. Proper credit should also be recorded in the individual share account.

If numerous debit and credit entries are recorded as "Cash Over and Short" expense during the month,

separate totals can be taken of the items in red or parentheses and those in black. The total of the red items can then be subtracted from the total of the black items to obtain the net overage or shortage. If there is a net overage at the end of the month, it should be shown in red or in parentheses opposite the appropriate caption in the "Operating Expenses" Section of the Statement of Income and should be deducted from other expense items.

At each regular monthly meeting of the board of directors, the cash overages and shortages must be reported to the directors' for consideration and ratification. Some credit unions may find it informative to record cash over and short by teller. In this event, separate expense accounts may be established; e.g., Teller A, Teller B, Teller C. Any abnormal overages and shortages will thus be promptly brought to the directors' attention so that proper action can be taken in controlling operations and in complying with the terms of the credit union's surety bond.

Association Dues

This classification includes the membership dues and other fees paid to a credit union organization of which the credit union is a member.

Annual Meeting Expenses

This classification includes all costs incurred in connection with the annual meeting of shareholders; e.g., costs of rental of meeting room, printing of notices to shareholders, costs of carrying out and administering a mail ballot election program, etc.

Truth In Lending Expense (TIL)

TIL Reimbursement Of Interest Overcharges

This classification includes reimbursement expenses for overcharges under Regulation Z-Truth in Lending enforcement for accounting periods subsequent to the first examination period in which reimbursement is required.

TIL Restitution

This classification includes restitution costs for expenses incurred for other than interest overcharges under Regulation Z-Truth in Lending enforcement. These costs should be the result of activities within the current accounting period.

Charitable Contributions

This classification includes charitable contributions and donations authorized by the board of directors. Section 701.25 of NCUA's Rules and Regulations permits FCUs to make charitable contributions to: (1) recipients not organized for profit that are located in or conduct activities in a community in which the FCU has a place of business, or (2) organizations that are tax exempt under Section 501 (c)(3) of the Internal Revenue Code and operate primarily to promote and develop credit unions.

Miscellaneous Operating Expenses

This classification includes miscellaneous expenses for which no separate expense classification is provided. The nature of the expense should be noted as an "Account" in the Journal and Cash Record. If a particular type of expense shown in this miscellaneous grouping represents a comparatively large amount of the total for this group, it may be shown as a separate item. If, for example, any expenses are large in relation to the other items in Miscellaneous Operating Expense, these expenses may be charged to a special expense account established by the credit union under the appropriate main grouping of expense classifications. These expenses would then be merged with and reported in the total for the designated expense grouping in the Statement of Income for the period.

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PURPOSE

Financial reports disclose a summary of the credit union's financial condition and results of operations as of a specific date or time period to the members and other users. Display a copy of the reports so members may review the financial condition of their credit union, and potential members can make an informed decision on the likelihood of future dividends. Submit copies to the directors for considera-

tion at their regular meetings. Suggested statements include:

- Statement of Financial Condition,
- Statement of Income, and
- Statement of Changes in Members' Equity.

In addition, credit unions who obtain an independent accountant's opinion on their financial statements must display annually the audited

Statement of Cash Flows and Statement of Comprehensive Income or alternative presentation of comprehensive income.

FREQUENCY OF REPORT DISTRIBUTION

NAME OF REPORT	FREQUENCY	APPLICABLE TO
Statement of Financial Condition	Monthly	All FCUs
Statement of Income	Monthly	All FCUs
Statement of Changes in Members' Equity	Quarterly or at the end of the regular share account dividend period — if the dividend period is longer than quarterly	All FCUs
Statement of Cash Flows	At least annually	All FCUs who obtain an independent accountant's opinion on their financial statements
Statement of Comprehensive Income (or alternative presentation)	At least annually	All FCUs who obtain an independent accountant's opinion on their financial statements

REPORTS REQUIRED BY THE NCUA

Federal credit unions submit periodic Call Reports to the NCUA as and when the Administration may require. The NCUA Rules and Regulations specify when reports are required.

Federal Credit Unions also post financial statements at the credit union for members or may issue financial statements in its annual report. For credit unions under \$10 million in assets, these financial statements should follow the prescribed form herein, a similar format, or be prepared consistent with GAAP.

Individual federal credit unions are not required to file statements with the IRS or main-

tain an informational return. NCUA is no longer obligated to file a consolidated Form 990. The Federal Credit Union Act (FCUA) exempts federal credit unions from federal, state, and local income tax. The tax exemption falls under Section 501(c)(1) of the Internal Revenue Code. Organizations falling under the 501(c)(1) code exemption do not have to file an informational return or make such a return available for inspection.

FORMAT OF FINANCIAL REPORTS

NCUA does not provide financial statement forms but suggest these standard formats to ease submission of financial reports other than the Call Report. These formats include:

- Statement of Financial Condition,
- Statement of Income, and
- Statement of Changes in Members' Equity.

The Supporting Schedules for Financial Statements illustration enables credit unions to provide a further breakdown of line items on the Statement of Financial Condition and/or the Statement of Income.

For the Statement of Cash Flows and the Statement of Comprehensive Income, refer to the illustrative statements included at the end of this section. Management should work with your independent accountant to develop an appropriate format. Credit unions may adopt a report format designed to satisfy their particular needs provided it accomplishes full and fair disclosure.

DESCRIPTION OF FINANCIAL REPORTS

STATEMENT OF FINANCIAL CONDITION

The Statement of Financial Condition, shown in Fig. 9-1 reports the credit union's financial condition as of a given date (month end). It is organized into three sections: assets (property), liabilities (obligations), and shares and equity (ownership). Total assets must equal total liabilities and equity.

Statement preparers must follow basic accounting concepts and measurement principles and standards. Include notes (if necessary, on a separate attachment) to identify any material transactions of an irregular nature and/or any significant changes in accounting practices adopted since the previous

presentation. Notes should include descriptions of the transactions' effects on the financial condition. Also, the statement should identify by note or otherwise:

- All significant accounting principles;
- Restricted cash separately from unrestricted cash;
- Nature and extent assets are pledged as collateral on borrowed funds;
- Nature and extent specific liabilities have a preferred lien on assets;
- Contingent losses;
- Specific details relating to pension plans;
- The number and aggregate dollar amount of member business loans; and
- Other significant events or activities that will provide full and fair disclosure.

The amount entered for "Undivided Earnings" will be the account balance after the following entries are made:

- 1) Closing the income and expense accounts into the Net Income (Loss) account, and
- 2) Transferring the balance of the Net Income (Loss) account to Undivided Earnings.

At the close of an accounting period, prepare the Statement of Financial Condition from the post-closing trial balance since this trial balance reflects the closing entries made to the Undivided Earnings account.

If management elects not to close its accounting records at the close of a dividend period, prepare the reports with interim adjustments made on a work sheet basis. This is necessary to give effect to the entries 1) and 2) as

Figure 9-1: Statement of Financial Condition

STATEMENT OF FINANCIAL CONDITION AS OF December 31, 200X

Internal Use Only Report Type_____		70089 Charter # or Ins. Cert. #_____		OUR FEDERAL_____		CREDIT UNION_____		
ASSETS				LIABILITIES AND EQUITY				
LOANS, CASH and INVESTMENTS			Dollar Amount	Acct. Code	LIABILITIES		Dollar Amount	Acct. Code
1. Cash and cash equivalents			53,778		10. Borrowed Funds			
Cash and due from banks			53,778		Notes Payable	Maturity ≤1 yr.	Maturity > 1 yr.	
Federal funds sold					Reverse Repo			
Short-term, interest-bearing funds in other financial institutions					Other			
2. Securities		Maturity 1 yr. or less	Maturity > 1 yr.	18,658		11. Accrued Dividends/Interest Payable		
Trading Accounts						12. Other Accrued Expenses and Accounts Payable		1,777
Available-for-Sale						TOTAL LIABILITIES		1,777
Held-to-Maturity			18,658	18,658		13. All Other Liabilities and Contingencies		
3. Other Investments		\$1,051,598		\$1,051,598		14. Members' Shares and Savings Accounts [Sum a) through f)]		1,632,158
Shares, Deposits & CDs in Corporates			18,642		a) Share Certificates			
Shares, Deposits & CDs in CUs, Banks, and S&Ls			1,032,956		b) Share draft accounts			
Shares in Central Liquidity Facility					c) IRA/Keogh & Retirement Accounts			
Other					d) Other Member Savings			
4. Loans Held-for-Sale					e) Member's deposits (SCU's only)			
5. Loans Receivable, Net				852,725	f) Non-member savings			
Commercial and Agricultural					EQUITY			
RE to Members (first lien), original maturity > 12 Years			127,013		15. Reserves		47,982	
Fully Secured			92,630		Regulatory/Statutory Reserves		47,982	
Other Loans to Members			634,718		Investment Valuation Reserve (SCU's Only)			
Total Loan to Members [Sum i) through iv)]			854,361		Special Reserves			
All Other Loan Accounts (not included above)					Other Reserves			
(Less) Allowance for Loan Losses			1,636		16. Uninsured Secondary Capital (CDCUs)			
OTHER ASSETS					17. Undivided Earnings (Post-Closing)		315,753	
6. NCUSIF Deposit				15,108	18. OCI--Accumulated Unrealized G/L on AFS			
7. Land and Buildings, Net					TOTAL MEMBER'S EQUITY			
8. Other Fixed Assets, Net				3,555	TOTAL LIABILITIES AND EQUITY		\$1,997,670	
9 All Other Assets				2,248	Fair value of Held-to-Maturity Securities			
TOTAL ASSETS [Sum bolded items]				\$1,997,670	U.S. Government Obligations			
					Federal Agency Securities			
					Other HTM Securities			

Figure 9-2: Statement of Income

STATEMENT OF INCOME FOR THE PERIOD ENDED December 31, 200X

Internal Use Only Report Type	Acct. Code No. 100	70089 Charter # or Ins. Cert. #		OUR FEDERAL CREDIT UNION Refer to accompanying Statement of Undivided Earnings for change in Undivided Earnings		
INTEREST INCOME		Month TD	Qtr-TD	YTD	CLASSIFICATION OF LOANS O/S	
19. Interest on Loans (Gross)		3,422	10,266	41,062	Degree of Delinquency	Dollars Number
20. Less: Interest Refunded					52. Current and < 2 mons.	
21. Income from Trading Securities					53. 2 to less than 6 mons.	
22. Income from Debt Securities		2,195	6,586	26,343	54. 6 to less than 12 mons.	
23. Other					55. 12 mons. and over	
24. Total Interest Income [Sum above lines]		5,617	16,852	67,405	56. Total Loans [Sum 51.-54.]	
INTEREST EXPENSE					MISCELLANEOUS INFORMATION	
25. Dividends		2,553	7,659	30,637	57. Number of members at end of month	597
26. Interest on Borrowed Money				57	58. Number of potential members	1,800
27. Total Interest Expense [Total Previous Two Lines]		2,553	7,659	30,637	OTHER LOAN INFORMATION	
28. Net Interest Expense [Total Interest Income less above line]		3,064	9,193	36,768	59. Loans sold and being serviced	
29. Less: Provision for Loan Losses					60. RE loans made during year	
30. Net Interest Income After PLL		3,064	9,193	36,768	61. Total loans made during year	302,369 79
OTHER NON-INTEREST INCOME					62. Loans since organization	
31. Net gain (loss) on sale of available-for-sale securities					63. Total loans charged-off YTD	
32. Net gain (loss) on trading securities					64. Recovery of loans charged-off YTD	
33. Member service fees					65. Net loans charged-off YTD	
34. Loan servicing fees					<p>We certify, to the best of our knowledge and belief, this statement and the related statements are true and correct and present fairly the financial position and the results of operations for the periods covered.</p>	
35. Insurance commissions						
36. Net gains on sale of loans						
37. NCUSIF Refund						
38. Other Income			11,875	11,875		
39. Non-Interest Income (Total 30.-37.)			11,875	11,875		
NON-INTEREST EXPENSES						
40. Employee Compensation and Benefits		819	2,459	9,835		
41. Travel & Conference						
42. Office Occupancy Expense		448	1,344	5,378		
43. Office Operation Expenses		97	290	1,162		
44. Educational and Promotional		32	97	388		
45. Loan Servicing Expense						
46. Professional & Outside						
47. Member Insurance		265	796	3,183		
48. Operating Fees (Exam)		78	233	934		
49. Miscellaneous Operating		73	217	870		
50. Total Operating Expense [Total Previous 10 Lines]		1,812	5,436	21,750		
51. NET INCOME		1,252	15,632	26,893		

Certified Correct by:

Telephone No.

Treasurer/Manager

Date

President/Authorized Officer

Date

described in the preceding paragraph. Then prepare the financial reports in the same manner as though the books were closed.

STATEMENT OF INCOME

The Statement of Income, shown in Fig. 9-2 reflects all income, expenses, gains, and losses. It segregates net interest income, other operating income and expense, and non-operating income and expense. The provision for loss expenses is applied to net interest income.

Three columns are provided on the form for recording income, expenses and gains or losses:

- 1) Current month,
- 2) Quarter-to-date, and
- 3) Year-to-date.

If the books are closed just once in a year, only the Year-to-Date column reports amounts of income, expenses, gains, and losses. If the books are closed quarterly or at the end of the regular share account dividend period, or if the dividend period is longer than quarterly, the Year-to-Date column reports the calendar year cumulative totals through the date the books were last closed plus the amounts of income, expenses, gains, and losses after the last closing date.

Report operating expenses in the Year-to-Date column based upon totals for each grouping of expense accounts. For example, the single reported amount for Office Occupancy Expenses includes the total of expense accounts such as rent, utilities, real estate taxes, building maintenance, etc.

Income and expenses in the current Month and Quarter-to-Date columns represent the net postings for the current month and the current quarter-to-date as shown in the income,

expenses, gains and losses accounts for the period identified in the column heading.

Classifying Outstanding Loans

Obtain this information from the Schedule of Delinquent Loans and the Statement of Financial Condition. This portion of the Statement of Income provides a breakdown of the number and amount of delinquent loans outstanding.

Other Loan Information

This portion of the Statement of Income discloses a breakdown of the number and amount of:

- Loans sold and serviced by the credit union;
- Real estate loans made in the current year;
- Total loans made in the current year; and
- Total loans made since the credit union's organization.

Also, it reports the total amount of charged-off loans, recoveries, and net charged off loans year-to-date.

Miscellaneous Information

This section reports the number of members of record and the number of potential members as of the month end.

SUPPORTING SCHEDULES FOR FINANCIAL STATEMENTS

Use this form, shown in Fig. 9-3 to provide additional information for any line item on either the Statement of Financial Condition or the Statement of Income. For example, Cash may consist of Cash-Checking Accounts, Petty Cash, and Cash Fund. If this

Figure 9-3: Supporting Schedules for Financial Statements

SUPPORTING SCHEDULES FOR FINANCIAL STATEMENTS					
<u>70089</u>				<u>December 31, 200X</u>	
Charter # or Ins. Cert. #		<u>OUR FEDERAL</u>		CREDIT UNION	
				Date	
Schedule	Ref. No.	Account Title	Acct. No.	Debit	<u>Balances</u> Credit
A	1.	Cash-Checking Accounts		49,028	
		Petty Cash		250	
		Cash Fund		4,500	
		Balance		<u>53,778</u>	
B	6.	Furniture and Equipment		5,750	
		Allowance for Furniture and Equip- ment			2,195
		Balance		<u>3,555</u>	
K	33.	Rent		4,250	
		Utilities		1,000	
		Other Office Occupancy Expenses		128	
		Balance		<u>5,378</u>	
Etc.					

is the first supporting schedule, label it Schedule A on the Statement of Financial Condition and on the Supporting Schedules for Financial Statements. Refer to the Statement of Financial Condition. The account number is the general ledger account number. Use the remaining two columns for balances or appropriate dollar amounts.

STATEMENT OF CHANGES IN MEMBERS' EQUITY (EXCLUDING SHARES)

This statement is shown in Fig. 9-4. Prepare and display this statement with the regular financial reports at least quarterly or at the end of the regular share account dividend period, if the dividend period is longer than quarterly. Management may also incorporate this statement with other financial reports at any time.

The statement reports changes in members' equity (excluding shares) during the reporting period. It shows the total increases and total decreases in each equity (ownership) account. Base the report on an analysis of the debits and credits during the reporting period in certain "Equity" general ledger.

STATEMENT OF COMPREHENSIVE INCOME

As stated in Section 200 of this manual, federal credit unions with an annual opinion audit by an independent accountant must prepare the Statement of Comprehensive Income at least annually. Management may prepare it more frequently, but then an annual report should be prepared as of each year-end. Federal credit unions without an opinion audit may also prepare this statement.

Several formats are permitted for the presentation of this statement. For illustrative purposes, Fig. 9-4 includes the presentation of comprehensive income within the Statement of Member's Equity. Use this format or a permissible alternative format to report comprehensive income. Management may confer with an independent accountant concerning the best format for the credit union.

Comprehensive income is "the change in credit union's equity (net assets) during a period, from transactions and other events and circumstances from non-owner sources (excluding shares). It includes all changes in equity, except those resulting from investments by owners (excluding shares) and distributions to owners (excluding share dividends)." An example of a component of comprehensive income is the change in Accumulated Unrealized Gains or Losses on Available-for-Sale Securities.

To avoid double-counting items displayed as part of other comprehensive income in the period, or earlier periods, preparers must make various reclassification adjustments to comprehensive income. For example, the preparer must deduct gains on investment securities realized and included in net income of the current period through other comprehensive income of the period when they are included in net income — because they are also included in other comprehensive income as unrealized holding in the period the gains arose. This reclassification adjustment will avoid double-counting the gains in comprehensive income.

Figure 9-4: Statement of Changes in Members' Equity (Excluding Shares)

**STATEMENT OF CHANGES IN MEMBERS' EQUITY (Excluding Shares)
FOR THE PERIOD ENDED December 31, 200X**

<div style="display: flex; justify-content: space-between; align-items: center;"> <div style="text-align: center;">OUR FEDERAL</div> <div style="text-align: center;">CREDIT UNION</div> <div style="text-align: right;"> 70089 Charter # or Ins. Cert. # </div> </div>						
	TOTAL	TOTAL COMPREHENSIVE INCOME		APPROPRIATED EARNINGS		UNAPPROPRIATED EARNINGS
		COMPREHENSIVE INCOME	ACCUMULATED OTHER COMPREHENSIVE INCOME	REGULAR RESERVES (ACCT. 931)	OTHER RESERVES	UNDIVIDED EARNINGS (ACCT. NO. 940)
66. Beginning balance	336,842		0	47,982	0	288,860
Comprehensive income:						
67. Net income	26,893	26,893				26,893
68. Other comprehensive income						
a) Unrealized gain or loss on AFS securities, net of reclassification adjustment (below) ¹	0	0				
b) Other comprehensive income		0	0			
69. Comprehensive income:		26,893				26,893
70. Transfers:						
a) Required Transfer to Regular Reserve	--			--		--
b) Special Transfers	--			--		--
c) Other Transfers	--			--		--
d) Total Transfers	0			0		0
71. Uninsured Secondary Capital (CDCUs)	--				--	
72. Ending Balance	363,735		0	47,982	0	315,753

¹ **Disclosure of reclassified amount:**

Unrealized holding gains and losses during period	0
Less: reclassification adjustment for amounts included in net income	0
Net unrealized gains/losses on securities	0

Figure 3-4A better illustrates comprehensive income effect; This figure includes no comprehensive income adjustments.

Figure 9-4A: Statement of Changes in Members' Equity (Excluding Shares) (Illustrating Comprehensive Income)

**STATEMENT OF CHANGES IN MEMBERS' EQUITY (Excluding Shares)
FOR THE PERIOD ENDED December 31, 200X**

OUR FEDERAL		CREDIT UNION		70089		
				Charter # or Ins. Cert. #		
	TOTAL	TOTAL COMPREHENSIVE INCOME		APPROPRIATED EARNINGS		UNAPPROPRIATED EARNINGS
		COMPREHENSIVE INCOME	ACCUMULATED OTHER COMPREHENSIVE INCOME	REGULAR RESERVES (ACCT. 931)	OTHER RESERVES	UNDIVIDED EARNINGS (ACCT. No. 940)
66. Beginning balance	336,842		0	47,982	0	288,860
<u>Comprehensive income:</u>						
67. Net income	26,893	26,893				26,893
68. Other comprehensive income						
a) Unrealized gain or loss on AFS securities, net of reclassification adjustment (below) ¹	(7,500)	(7,500)				
b) Other comprehensive income		0	0			
69. Comprehensive income:		19,393				19,393
70. Transfers:						
a) Required Transfer to Regular Reserve	--			--		--
b) Provision for Loan Losses	--			--		--
c) Other Transfers	--			--		--
d) Net Transfers	0			0		0
71. Uninsured Secondary Capital (CDCUs)	--				--	
72. Ending Balance	356,235		0	47,982	0	308,253

¹ **Disclosure of reclassified amount:**

Unrealized holding gains and losses during period	(7,500)
Less: reclassification adjustment for amounts included in net income	0
Net unrealized gains/losses on securities	(7,500)

INSTRUCTIONS FOR PREPARING THE STATEMENTS OF FINANCIAL CONDITION, STATEMENT OF INCOME, SUPPORTING SCHEDULES FOR FINANCIAL STATEMENTS, AND STATEMENT OF CHANGES IN MEMBERS' EQUITY.

Refer to Figures 9-1, 9-2, 9-3 and 9-4.

ASSETS

<u>ITEM</u>	<u>TITLE and DESCRIPTION</u>
--------------------	-------------------------------------

1-	Cash and cash equivalents. Cash on hand, petty cash, checking accounts; federal funds sold; and short-term, interest-bearing funds in other financial institutions, etc.
-----------	---

2-	Securities.
-----------	--------------------

Trading Securities. The fair value of securities held principally for sale in the near term (within hours or days).

Available-for-Sale Securities. The fair value of securities not meeting the GAAP-criteria for held-to-maturity or trading (sale within months or years).

Held-to-Maturity Securities. The amortized cost of investments management has the positive intent and ability to hold to maturity. Exclude prepaid securities or securities otherwise settled in such a way management would not recover substantially all of its recorded investments.

3-	Other Investments. Shares, Deposits & CDs in Corporates; CUs, Banks, and S&Ls; Shares in CLF; and Other Deposits not meeting the definition of a cash equivalent (maturity generally greater than 3 months.)
-----------	---

Shares, Deposits, and Certificates Invested in Corporate Central Credit Unions. The total amount of shares, deposits, and certificates invested in Corporate Central Credit Unions. Do not include special share accounts established in a corporate central credit union to fund the corporate central's Central Liquidity Facility stock subscription; report such accounts in item 4-d. Add the amounts reported in columns: "Maturity 1 Yr. Or Less" and "Maturity Greater Than 1 Yr." to equal the amount in "Dollar Amount".

Shares, Deposits, and Certificates in Other Credit Unions, Banks, S&Ls, and Mutual Savings Banks. The amount of outstanding shares, deposits, and certificates of other credit unions, banks, S&Ls and MSBs. Add the amounts reported in columns: "Maturity 1 Yr. Or Less" and "Maturity Greater Than 1 Yr." to equal the amount in "Dollar Amount".

Shares in Central Liquidity Facility. The total amount of shares invested directly or indirectly in the Central Liquidity Facility. Credit unions with access to the Central Liquidity Facility (CLF) through a CLF Agent should include the amount of their "CLF Stock Reimbursement" (a special share account in a corporate central to fund the corporate central's CLF stock subscription). A corporate central credit union that is a member of a CLF Agent Group should include the amount it invested in its Agent Group Representative (AGR) to reimburse the AGR for purchasing CLF stock on its behalf.

All Other Investments. All investments (not securities) not reported above. Include loans to other credit unions, investments and loans to CUSOs. Do not include CLF investments or NCUSIF deposit.

4. Loans Held for Sale. The value of loans either identified for sale at origination or subsequently, for which there has been a decision to sell.

5. Loans Receivable, Net. The value of portfolio loans outstanding less the Allowance for Loan Losses.

Commercial (Business Loans) and Agricultural. Report the total amount of loans over \$50,000 (aggregate to one borrower or associated member) for business, inventory, and commercial purposes; plus all loans for the purpose of farming, raising livestock, or the purchase of farm equipment or loans secured by farmland, equipment or crops.

Real Estate Loans. Report the total amount of real estate loans to members outstanding as of the report date. Report only those loans with original maturities in excess of 12 years.

Share Secured Loan Balances (Fully Secured by Shares). Report the amount of loans to members outstanding as of the report date that are completely secured by pledged shares.

All Other Loans to Members. This amount should be the residual of loans to members after deducting commercial and agricultural loans, real estate loans, and share secured loan balances fully secured by shares have been deducted. Include loans classified as collateral in process of liquidation.

Total Loans to Members. All loans to members (including commercial loans, agricultural loans, real estate loans and share secured loans) outstanding as of the report date. Do not include loans to other credit unions. Report these in the investments section.

All Other Loan Accounts. All other loan accounts such as loans purchased, in whole or in part, from other credit unions, any note or contract receivable resulting from the sale of assets and similar accounts, if any. Include loans subject to repurchase agreements and nonmember loans. Do not include loans to other credit unions. Report these in the investment section.

(Less) Allowance for Loan Losses. This item, if applicable, represents the amount estimated by management for existing probable losses inherent in the loan portfolio.

6- NCUA Share Insurance Capitalization Deposit. The outstanding balance of the credit union's NCUA Share Insurance Deposit.

7- Land and Building (Net). The amount of land and building less depreciation on building, if any.

8- Other Fixed Assets, Net. All other fixed assets such as furniture and fixtures, leasehold improvements, less related depreciation items, if any

9- All Other Assets. All other assets of the credit union not included in the above items. Includes such items as prepaid expenses and insurance, accounts receivable, accrued income, etc.

Total Assets. Represents the sum of the amounts in items 1. through 9. bolded above.

LIABILITIES/SAVINGS EQUITY

10- Borrowed Funds.

Notes Payable. The amount of the credit union's liability for borrowed funds. Add the amounts reported in columns: "Maturity 1 Yr. Or Less" and "Maturity Greater Than 1 Yr." to equal the amount in "Dollar Amount".

Reverse Repurchase Transactions. The outstanding balance of funds borrowed from any source using securities as collateral. Add the amounts reported in columns: "Maturity 1 Yr. Or Less" and "Maturity Greater Than 1 Yr." to equal the amount in "Dollar Amount".

Other Borrowed Funds. All other borrowed funds outside the classifications above. Include "Accrued Interest Payable" because it represents the amount of interest accrued on all notes and borrowings

11- Accrued Dividends/Interest on Shares/Deposits Payable. The total amount of dividends/interest on shares/deposits payable declared, and not paid, for the last dividend period.

12- Other Accrued Expenses and Accounts Payable. All accounts payable such as undistributed payments, undistributed payroll deductions, etc.

Total Liabilities. Represents the sum of the amounts in items 10. through 12. bolded above.

13- All Other Liabilities and Contingencies. All liability accounts not shown separately above. Include such items as taxes payable, accrued expenses, deferred income, and Unapplied Data Processing Exceptions, etc.

- 14- Total Savings/Shares/Deposits.** The sum of amounts held in all savings/shares/deposits accounts of members and nonmembers. Includes share certificates, share draft accounts, public unit accounts, retirement plans, and special share accounts such as Christmas and vacation accounts, if any. The sum of a) through f) below.
- a. Share Certificates and Time Deposits.** The total amount of regular, money market, jumbo, and other share certificates and time deposits held by credit union members, if any. Add the amounts reported in columns: "Maturity \leq 1 Yr." and "Maturity > 1 Yr." to equal the amount in "Dollar Amount".
 - b. Share Draft Accounts.** The total amount of share draft accounts held by credit union members.
 - c. IRA/Keogh and Retirement Accounts.** The amount of member funds deposited for retirement purposes under a trust or custodial agreement.
 - d. Other Member Savings.** Total member savings excluding share draft accounts, share certificates, member deposits, and IRA/Keogh and retirement accounts.
 - e. Member Deposits.** The amount of deposits (not shares) of members. For use by state-chartered credit unions only.
 - f. Nonmember Savings.** The total amount of nonmember deposits. Primarily applicable to Community Development Credit Unions.
- 15- Reserves.**
- Regular/Statutory Reserve.** The statutory (regular) reserve balance.
 - Investment Valuation Reserve (SCU's only).** Reserves to cover the excess of book value over market value for held-to-maturity securities and investments (not securities) other than those authorized for federal credit unions by Section 107 of the FCUA. For use by state-chartered credit unions only.
 - Special Reserves.** Any other reserves required by regulation, special agreement, or other of the credit union's supervisory authority.
 - Other Reserves.** The sum of other reserve accounts created by management such as reserve for contingencies, appropriated undivided earnings, etc.
- 16- Uninsured Secondary Capital.** For low-income (community development) designated credit unions only. The amount of secondary capital accounts accepted from organizational or institutional investors.
- 17- Undivided Earnings, Post-Closing.** The total amount of accumulated income or surplus. As a post-closing amount, it includes the net income (loss) from operations.

- 18- Accumulated Unrealized Gain/Losses on Available-for-Sale Securities.** The accumulated unrealized and unrecognized gains and losses (net) on securities classified as available-for-sale.

Total Equity. Represents the sum of amounts in items 14 through 18.

Total Liabilities and Equity. Represents the sum of Total Liabilities and Total Equity plus item 13.

Fair Value Of Held-To-Maturity Securities.

U.S. Government Obligations. The fair value of U.S. Government Obligations management has the intent and ability to hold to maturity.

Federal Agency Securities. The fair value of Federal Agency Securities management has the intent and ability to hold to maturity.

All Other Investments. Identify all other securities in HTM with fair values less than the booked amounts and report the fair value for the investment's management has the intent and ability to hold to maturity.

OPERATING INCOME

- 19- Interest on Loans (Gross).** The total amount of income from interest on loans.
- 20- (Less) Interest Refunded.** The total amount of interest refunded.
- 21- Income From Trading Securities.** The total amount of income earned on trading securities (excluding disposition gains or losses).
- 22- Income from Debt Securities.** The total amount of income earned on debt securities, available-for-sale and held-to-maturity.
- 23- Other Interest Income.** Miscellaneous interest income not reported above.
- 24- Total Interest Income.** Sum of items 18 through 23 above.

INTEREST EXPENSE

- 25- Dividends.** The actual or estimated amount of dividends for the reporting period.
- 26- Interest on Borrowed Money.** The interest expense for borrowed money.
- 27- Total Interest Expense.** Sum of items 25 and 26.
- 28- Net Interest Income.** The gross profit of the credit union (item 24 minus item 27).
- 29- Provision for Loan Loss.** The current period Provision for Probable Losses and related costs on loans and other loan receivables.

- 30- Net Interest Income After Provisions for Losses.** Gross profit less Provisions for Loan Losses (item 28 minus 29).

OTHER NON-INTERST INCOME

- 31- Net Gain (Loss) on Available-for-Sale Securities.** The amount the gain or loss on disposition of available-for-sale securities.
- 32- Net Gain (Loss) on Trading Securities.** The amount of gain or loss on disposition of trading securities.
- 33- Member service fees.** Service fees collected from members, excluding those on loan servicing.
- 34- Loan Servicing fees.** Fees collected on the servicing of loans.
- 35- Insurance commissions.** Commissions earned on permissible insurance services to members.
- 36- Net gains on sale of loans.** The amount of gain or loss on disposition of loans.
- 37- NCUSIF Refund.** Refunds received as authorized by the NCUA Board on the NCUSIF deposit.
- 38- Other Income.** All operating income other than interest on loans, income from investments, and gain or loss on trading accounts.
- 39- Non-Interest Income.** Total 31.-38.

NON-INTERST EXPENSE

- 40- Employee Compensation and Benefits.** Compensation is the total amount of salaries paid to credit union employees, including the treasurer, if paid. Also includes sponsor reimbursement when employees are on the sponsor company's payroll. Benefits are all expenses relating to employee benefits. Includes pension plan costs, employer's social security taxes, unemployment compensation taxes, and other benefits provided to employees.
- 41 Travel and Conference Expense.** The amount of authorized expenses incurred by employees and officers for travel and attendance at conferences and other meetings.
- 42- Office Occupancy Expense.** All expenses relating to office occupancy including rent, utilities (except telephone), building depreciation, if owned, real estate taxes, and leasehold improvements amortization.
- 43- Office Operation Expense.** All expenses relating to office operations including communications, stationery and supplies, insurance, furniture rental and/or maintenance, depreciation, bank service charges, etc.

- 44- Educational and Promotional Expense.** Includes advertisements or notices in newspapers, periodicals, radio, or television; publicity for member education; and other promotional expenses.
- 45- Loan Servicing Expense.** All expenses incurred in servicing loans such as collections, credit reports, recording fees, chattel lien insurance, etc.
- 46- Professional and Outside Services.** Expenses incurred for such items as legal fees, audit fees, accounting services, and management and consultant fees.
- 47- Member Insurance.** The cost of members' insurance, including premiums paid for life savings insurance, annual share insurance premium and borrowers protection insurance.
- 48- Operating Fees.** The NCUA annual operating fee, state supervision fee, and the cost of periodic examinations assessed by the supervisory agency, if any.
- 49- Miscellaneous Operating Expense.** Includes all miscellaneous operating expenses not separately listed.
- 50- Total Operating Expenses.** Sum of all operating expenses. Items 39 through 50.
- 51- Net Income (item 30 plus items 39 and minus 50).** The net profit or loss.

CLASSIFICATION OF LOANS OUTSTANDING

- 52-56 Classification of Loans Outstanding.** The number and amount of delinquent loans: current and less than 2 months delinquent; 2 and less than 6 months delinquent; 6 and less than 12 months delinquent; and 12 months and more delinquent. Obtain information on delinquent loans from a delinquent loan schedule as of the report date.
- 57- Number of Members at End of Month.** The actual number of members on record. Do not enter the number of accounts.
- 58- Number of Potential Members.** The number of actual members plus persons in the field of membership who have not joined the credit union. If utilizing field of membership data stated in terms of families, use an average of three persons per family to estimate the total individual potential membership.
- 59- Loans Sold and Being Serviced by the Credit Union.** The number and outstanding dollar amount of loans sold to others serviced by the credit union.
- 60- Real Estate Loans Made During Current Year.** The number and dollar amount of real estate loans (first liens with original maturities over 12 years) made during the current year.
- 61- Total Loans Made During Current Year.** The total number and amount of loans made during the current year.

- 62- Loans since organization.**
- 63- Total Loans Charged Off Year-to-Date.** The total amount of loans charged off year-to-date.
- 64- Recoveries on Loans Charged Off Year-to-Date.** The total amount of recoveries on previously charged off loans year-to-date.
- 65- Net Loans Charged Off Year-to-Date.** Net charge offs year-to-date; item 63 less item 62. This amount may be negative.

MEMBER'S EQUITY AND COMPREHENSIVE INCOME

- 66- Members' Equity Balance, Beginning of Period.** The beginning of period balances for the accumulated other comprehensive income, statutory reserve, other reserves, and undivided earnings. These balances may be translated from the previous period's Statement of Financial Condition, line items 15, 16, 17, and 18. Although NCUA considers shares part of equity, they are excluded in consideration of the Changes in Members' Equity (excluding shares).
- 67- Net Income/Loss.** The amount shown on the Statement of Income, Line item 51.
- 68- Other Comprehensive Income.**
- a. Unrealized gain or loss on AFS securities, net of reclassification adjustment.** Accumulated unrealized gains or losses corresponding to available-for-sale securities. Line item 68 should equal line item 18 on the Statement of Financial Condition.
 - b. Other Comprehensive Income.**
- 69- Comprehensive Income.** Total of line item 51, net income, and line item 68 b. other comprehensive income. Includes all changes in equity during a period except those resulting from investments by owners (excluding shares) and distributions to owners (excluding share dividends).
- 70- Transfers**
- a. Required Regular Reserve Transfer.** The current period transfer of Undivided Earnings to Regular Reserve consistent with requirements of Prompt Corrective Action and based on net worth classification, (Item 15. on the Financial Condition).
 - b. Special Transfers.** Other statutory or regulatory required transfers from undivided earnings not provided for elsewhere.
 - c. Other Transfers.** Discretionary appropriations of Undivided Earnings as determined necessary/expedient by the credit union board.

d. **Total Transfers.** The total of items 70 a. through c.

- 71- Uninsured Secondary Capital (CDCUs).** The capital portion of a CDCU's subordinated debt calculated on a sliding scale consistent with regulatory requirements. Uninsured secondary capital is the matching funds required for CDCU's participating in the Treasury Department's Community Development Financial Institution's Fund (CDFI).
- 72- Ending Balance.** The end of period balances for accumulated other comprehensive income, statutory reserve, other reserves, and undivided earnings. Cross-foot statement to total ending balance column.

STATEMENT OF CASH FLOWS

As stated in Section 200 of this manual, management must prepare the Statement of Cash Flows at least annually if they receive an opinion audit by an independent accountant. Management may prepare it more frequently than fiscal year end. Federal credit unions without opinion audits may also wish to prepare the statement.

The Statement of Cash Flows illustration uses the basic information illustrated for Our Federal Credit Union from Figures 9-1, 9-2, and 9-3. Report the cash effects of management's operating activities, investing activities, and financing activities. Explain the changes during the period in cash and cash equivalents. Figures 9-5C and 9-5D are illustrations of some of the preliminary work papers for the Statement of Cash Flows.

There are two ways to report cash flows:

- 1) Gross receipts and gross payments, or
- 2) Net receipts and/or payments.

Federal credit unions use the net/receipts or payments method. Items qualifying for "net" reporting are cash flows from all investments, loans, and debt with original maturities of 3 months or less (considered to be short term).

Also, share draft accounts and any other types of share accounts management is basically holding and disbursing cash on behalf of the member.

NOTES TO THE FINANCIAL STATEMENTS

Notes provide information that cannot be sufficiently described within the body of the financial statements without detracting from the clarity of the statements. Do not use notes as a substitute for proper accounting entries, accounting classifications, valuations, or descriptions. Do not contradict items disclosed within the financial statements.

Common types of notes are:

- a) Explanations of creditors rights to specifically pledged assets;
- b) Explanations of changes in accounting methods or techniques;
- c) Disclosure of contingent assets and liabilities, restrictions on dividend payments, and executory contracts; and
- d) A description of accounting policies used.

Exercise caution when preparing notes to accompany the financial statements. Readers may disregard notes if they are difficult to un-

derstand and read without further research and analysis.

Illustration of The Use of Notes To The Financial Statements

To continue with the credit union example set forth in this chapter, following are the related

illustrative notes to the financial statements. Independent accountants or another qualified accounting professionals of your choosing can advise you further on the use and content of footnotes and related disclosures, especially those credit unions seeking an opinion audit. Most often these footnote disclosures are those which the independent accountant would prepare to accompany audited financial statement on which he/she is rendering an opinion.

Figure 9-5A: Illustration of Statement of Cash Flows

Our Federal Credit Union Statement of Cash Flows For the Year Ended December 31, 200X		
Cash flows from operating activities:		
Interest received	68,027	
Fees and commissions received	11,875	
Proceeds from sales of trading securities		
Purchase of trading securities		
Financing revenue received under leases		
Dividends/Interest paid	(30,637)	
Cash paid to suppliers and employees	(19,217)	
Net cash from operating activities		30,048
Cash flows from investing activities:		
Proceeds from sales of securities (other than trading securities)		
Purchase of securities (other than trading securities)	(18,658)	
Loans made to members and principal collections, net	(61,998)	
Purchase of assets to be leased		
Principal payments received under leases		
Capital expenditures		
Proceeds from sale of property, plant, and equipment		
Other Investment Cash Flows		
Return of NCUSIF investment	960	
Net decrease in deposits in CUs, banks, and S&Ls	53,587	
Investment in Corporate	(18,642)	
Net cash from investing activities		(44,751)
Cash flows from financing activities:		
Net increase in demand deposits, NOW accounts, and savings accounts	36,027	
Net increase in federal funds purchased		
Net increase in 90-day borrowings		
Proceeds from issuance of non-recourse debt		
Proceeds from issuance of 6-month note		
Proceeds from issuance of long-term debt		
Repayment of long-term debt		
Other Financing Activity		
Net cash from financing activities		36,027
Net increase in cash and cash equivalents		21,324
Cash and cash equivalents at beginning of year		32,454
Cash and cash equivalents at end of year		53,778

Figure 9-5B: Illustration of Reconciliation of Net Income to Net Cash From Operating Activities

Our Federal Credit Union Statement of Cash Flows For the Year Ended December 31, 200X		
Net income		26,893
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation-Land and Buildings		
Depreciation-Furniture and Fixtures	1,328	
Provision for probable loan losses	1,000	
Loss on sales of securities (other than trading securities)		
Gain on sale of equipment		
Increase in trading securities		
Increase in interest receivable	622	
Increase in interest payable		
Decrease in fees and commissions receivable		
Increase in accrued expenses	205	
Total adjustments		3,155
Net cash provided by operating activities		30,048

Figure 9-5C: Illustration of Comparative Statements of Financial Condition

Our Federal Credit Union Comparative Statements of Financial Condition January 1 and December 31, 200X			
	12/31/0X	12/31/2X	Changes
Assets:			
Cash	32,454	53,778	21,324
Federal funds sold			
Total cash and cash equivalents	32,454	53,778	21,324
Trading Securities			
Available-for-Sale Securities			
Held-to-Maturity Securities		18,658	18,658
Loans	794,363	854,361	61,998
Allowance for Loan Losses	(2,636)	(1,636)	(1,000)
Interest receivable	2,870	2,248	(622)
Fees and commissions receivable			
Investment in direct financing lease			
Investment in Corporates		18,642	18,642
Investment in CUs, Banks, S&Ls	1,086,543	1,032,956	(53,587)
Investment in NCUSIF Deposit	16,068	15,108	(960)
Investment in Shares in CLF			
Property, plant, and equipment, net	4,883	3,555	(1,328)
Other			
Total assets	1,934,545	1,997,670	63,125
Liabilities and Equity			
Federal funds purchased			
Borrowings			
Dividends payable			
Accrued expenses	1,572	1,777	205
Other Liabilities			
Share Drafts			
All Other Share Accounts	1,596,131	1,632,158	36,027
Regular Reserve	47,982	47,982	
Undivided Earnings	288,860	315,753	26,893
Total liabilities and equity	1,934,545	1,997,670	63,125

Figure 9-5D: Illustration of Statements of Income

Our Federal Credit Union Comparative Statements of Income For the Year Ended December 31, 200X		
	12/31/0X	12/31/2X
Interest Income:		
Interest income	65,275	67,405
Total Interest Income	\$65,275	\$67,405
Interest Expense:		
Dividend/Interest expense	29,200	30,637
Total Interest Expense	\$29,200	\$30,637
Net Interest Expense	\$36,075	\$36,768
Less: Provision of loan losses		
Net Interest Income After PLL	\$36,075	\$36,768
Operating Expenses:		
Operating expenses	24,000	21,750
Total expenses	\$24,000	\$21,750
Other Operating Income:		
Fees and commissions	10,346	11,875
Lease income		
Total revenues	\$10,346	\$11,875
Non-operating Income:		
Net gain on sales of trading and other securities		
Gain on sale disposition of assets		
	0	0
Net income	\$22,421	\$26,893

OUR FEDERAL CREDIT UNION

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 200X

Note 1-Significant Accounting Policies

Investments. Our Federal Credit Union has the intent and ability to hold all securities to maturity, and as such, has classified such securities as held-to-maturity. Securities are stated at cost adjusted for amortization of premiums and accretion of discounts. Available-for-sale securities, when purchased, are carried at fair value as adjusted through member's equity. The gains and losses on dispositions are computed using the specific identification method.

Loans to Members. Loans are reported in the Statement of Financial Condition at book value. Interest income is recognized over the term of the loan and is generally computed using the simple interest method.

Allowance for Loan Losses. This account represents the amount set aside by management to absorb probable loan losses which exist as this financial statement date related to loans currently outstanding. The Allowance for Loan Losses is derived from charges made to the Provision for Loan Losses adjusted by charge-offs, and net of recoveries. The Allowance for Loan Losses represents management's evaluation of various factors influencing the collectability of individual loans and management maintains it at a level adequate to absorb probable losses which exist today related to loans currently outstanding.

Regular Reserve. The Our Federal Credit Union is required to maintain this statutory reserve in accordance with Section 116 of the Federal Credit Union Act. This required reserve represents an appropriation of Undivided Earnings. These amounts are not available for the payment of dividends.

Furniture and Equipment. This account represents all other fixed assets. Furniture and Equipment is stated at cost. Depreciation is computed over the estimated useful lives of the related assets using the straight-line method of depreciation.

Income Taxes. The Our Federal Credit Union is exempt from federal and state income taxes in accordance with Section 501(c) of the Internal Revenue Code and Section 122 of the Federal Credit Union Act.

Dividend Expense. The dividend rate is set by the board of directors on a quarterly basis for regular share accounts and dividends are charged to the Statement of Income when declared.

Note 2-Investments

The carrying value and approximate fair value of held-to-maturity securities are as follows:

	Carrying Value	Fair Value
Federal Agency Securities		
U.S. Government Obligations		
Other Securities	18,658.00	15,000.00
TOTAL	18,658.00	15,000.00

Note 3-Loans to Members

The composition of loans to members is as follows:

Commercial Loans		
Real Estate Loans (over 12 years)		\$127,013.00
Lines of Credit to Members		
Consumer Loans:		
Automobile Loans		
Education Loans		
Unsecured Loans	\$634,718.00	
Loans fully secured by shares	92,630.00	727,348.00
Total Loans to Members		\$854,361.00

Note 4-Allowance for Loan Losses

A summary of the changes in the Allowance for Loan Losses is as follows:

Balance on January 1, 200X		\$636
Add:		
Provision for Loan Losses Expense	--	
Recoveries on Charged-off Loans	1,000	
Subtotal		\$1,636
Less:		
Charged-off Loans	--	
Balance, December 31, 200X		\$1,636

Note 5-Other Assets

Other assets are summarized as follows as of December 31, 200X:

Other Fixed Assets:

Furniture and Equipment	\$4,883.00	
Less:		
Allowance for Depreciation of Furniture and Equip- ment	1,328.00	\$3,555.00
Accrued Interest on Loans		2,248.00
Other Assets		\$5,803.00
Total Other Assets		

Note 6-Savings Accounts

A summary of savings accounts is as follows:

			Percent of Total
<u>Share Certificates</u>			
Money Market Certificate Accounts	--		
Other Share Certificates	--	--	
<u>Share Draft Accounts</u>		--	
<u>Other Member Savings:</u>			
Shares-Regular		\$1,632,158.00	100%
Total Savings/Shares/Depos- its		\$1,632,158.00	100%

Note 7 - Related Party Transactions

Loans to credit union officials contain interest rates, terms, and collateral requirements comparable to those of other members. The aggregate amount of these loans is not significant to the financial statements. Employees of Our Company provide management and consulting services on a voluntary basis. The Our Federal Credit Union also uses the Our Company EDP facilities for processing daily transactions and preparing payroll. Our Company charges a nominal rate for these services. The Our Federal Credit Union does not consider the income or expense effects of these services to be material to the financial statements.

Note 8 - Commitments and Contingent Liabilities

The credit union is a party to various miscellaneous legal actions normally associated with financial institutions, the aggregate effect of which, in management's and legal counsel's opinion, would not be material to the Our Federal Credit Union's financial condition.